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Control of restrictive business practices in Latin America

UNITED NATIONS

UNCTAD/ST/MD/4

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

CONTROL OF RESTRICTIVE BUSINESS PRACTICES IN LATIN AMERICA

Study prepared by Mr. Eduardo White, Consultant, at the request of the UNCTAD secretariat*

UNITED NATIONS

1975

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* The author is an official of the Institute of Latin America Integration (INTAL). The views expressed in the study do not necessarily reflect those of the UNCTAD secretariat. The terminology used is that of the author. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimitation of its frontiers.

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GE.75-45034

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PREFATORY NOTE

The author wishes to state that the study could not have been undertaken without the assistance of a large number of people in governmental, professional and academic circles in the various Latin American countries, who gave freely of their knowledge and time to facilitate his task. The author would also like to acknowledge the support he received from the Manufactures Division of the UNCTAD secretariat, and his indebtedness to the officials of that Division, in particular Mr. C. Greenhill, for their valuable advice and suggestions.

SUMMARY AND CONCLUSIONS

(i) It is against a background of oligopoly and monopoly market structures, accompanied by a high degree of foreign domination in the industrial sectors in Latin America, that the main findings of this study concerning the control of restrictive business practices should be viewed.

(ii) In nearly every country in the region there seems to be a fairly clear distinction between, on the one hand, the treatment accorded to restrictive business practices connected with market power and the competitive relations which emerge and develop within the national economy; and, on the other, the treatment accorded to the restrictive practices which develop and operate in the context of international economic relations. The line of demarcation between the two categories of restrictive practices is not always easy to draw, given the inter-connexions between foreign and domestic enterprises, which are a common feature in developing countries. Nevertheless, there seems to have developed a definite though not always explicit tendency to distinguish between the treatment of "domestic" and imported" market power.

(iii) Direct control of restrictive business practices through anti-monopoly legislation has in general been of only marginal significance. Of the five laws enacted, namely in Argentina, Brazil, Chile, Colombia and Mexico, one has never been enforced (Mexico). Others have only at best been tentatively applied. The concepts of market power and dominant position have not been defined or developed in judicial or administrative decisions and seldom have such concepts served as a basis for governmental action. The brief record of their application seems to show that, in general, they have been applied more as instruments directly protecting consumers against certain price rises, rather than as devices for controlling market structures and situations of economic power. One of the difficulties in the application of the laws has been the complexity of the proof requirements in order for action to be taken. Another has been the absence of devices for preventive control. However, the principal difficulty would not seem to lie with the laws themselves, which cover a wide range of restrictive practices, but rather with their enforcement, in particular the fact that the competent authorities lack the autonomy and material resources they need to act as efficient organs of control.

(iv) The study gives the impression that, on account of the development of other areas of economic legislation and public administration in the five countries in which anti-monopoly laws have been enacted and which also happen to be the five countries with the highest level of industrial development in the region, the "inefficacy" of the laws is primarily due to changed economic circumstances and priorities and possibly to the lack of sufficient will to enforce them. In Argentina, Brazil, Colombia and Mexico, the laws seem to serve more as guidelines for the application of governmental economic policies rather than as bases for direct governmental action. For example, references are made to the need to avoid monopoly situations in the Mexican legislation on foreign investment and in the instruments used in Argentina, Brazil and Colombia for the control of prices and licensing agreements. In addition, in Colombia, the law may be regarded as establishing the primary rules of the game, namely a kind of "code of conduct" designed to guard against undue personal concentration of economic power. */ Moreover, in Argentina, the law would seem to have been regarded as a supplementary legal instrument to be used by the Government in exceptional cases in order to exert pressure. It must not be overlooked that the laws to encourage competition or directly to control abusive use of power may, in the future, given

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*/ In this connexion, see the bases of the recently proposed reform of the Law on the Control of Monopolies in the Ministry of Economic Development, *La politica del Ministerio de Desarrollo*, December 1971, Vol. I, pp. 191-201.

certain changes in development conditions in the countries concerned, be applied more energetically. In such an event it may, however, be necessary to revise the present legal and administrative systems so as to bring them into line with the changes that have taken place in the economic structures and over-all national development objectives.

(v) Around these laws directly concerned with the control of market power a body of policy instruments has been developed in these and other Latin American countries, dealing with such questions as price control, industrial promotion, State enterprises and the encouragement of industrial concentration. Whilst these instruments are not designed specifically to control restrictive business practices - and it is difficult to ascertain the exact extent to which they are used for this purpose - their scope, covering the main variables of economic behaviour, and their increased application, would seem to indicate that they have had and may have in the future important regulatory effects on the formation and exercise of market power. Price controls provide means for supervising the conduct of powerful enterprises. The application of investment licensing controls and industrial development incentives permit the regulation of market structures at the sectoral and at the individual economic unit level. Policies to promote greater State participation in the industrial and services sectors of an economy can result in the formation of State enterprises with strong countervailing market power in respect of the dominant power of both domestic private capital and foreign capital enterprises. Policies to promote industrial concentration can foster the establishment of medium-sized enterprises to compete with large enterprises. The main finding which emerges in relation to the use of indirect means of control of market power is that the Latin American countries considered have tended to adopt a pragmatic approach to the existence of dominant power of firms, and control is essentially exercised only when such power adversely affects national economic policies relating to such aspects as autonomous development, social welfare and industrial efficiency.

(vi) Control of restrictive business practices arising in the context of international economic relations is presently effected in the Latin American countries considered through bodies of legislation and administrative machinery that are separate from those relating to the control of restrictive business practices originating in relations or activities that are internal to national economies. One reason for this is probably that the possibilities of applying anti-monopoly type legislation to such practices is limited. In addition, the provisions in regional integration schemes aimed at fostering internal competition and trade liberalization through the control of restrictive practices have in general not been applied to date.

(vii) Government policies in Latin America with regard to the control of international restrictive business practices have two salient features. The first is the desire to bring legislation and policies relating to the treatment of the various restrictive practices into closer alignment. This results partly from a deliberate process of harmonization, which has been carried out within the context of regional integration schemes, in particular the Andean group, and partly from the spontaneous creation, in the region as a whole, of a kind of "common fund" of ideas and development models.

(viii) The second feature is the variety of instruments, approaches and procedures used in the different countries. The range of mechanisms used reflects on the one hand, the Governments' awareness of the varying types of restrictive practices, and, on the other, the search for appropriate methods of control through the system of "learning by doing". In some of the countries, controls have been only recently put into effect whilst in others there have been adjustments and corrections in the light of the brief experience of their operation. The variety of the approaches does not however necessarily reflect divergent aims but rather different degrees of freedom of choice in handling each particular issue and also possibly differences in pace and emphasis in the implementation of strategies that are basically similar.

(ix) The majority of Latin American countries have enforced new regimes for the regulation of foreign investment during the past few years. These regimes provide a comprehensive framework for handling a number of the major problems relating to the access and behaviour of foreign enterprises. In dealing with the various problems, the laws have placed particular attention on the control of restrictive business practices. This is evident in the legal criteria for the evaluation of the costs and benefits of investments, where attention has been given to the monopolistic consequences of new inflows of foreign capital, as, for example, in the laws of Argentina, Mexico and the Andean group; in the strict control of take-overs of national enterprises in most Latin American countries; and in the regulation of access of foreign firms to domestic credit and industrial development incentives, as, for example, in Argentina, Brazil and Mexico. The study also reveals a tendency in most of these countries for Governments to intervene directly in negotiations involving foreign enterprises, and, in a number of these countries, for the Governments themselves to conclude contracts directly with transnational corporations in order to control restrictive business practices, and to require specific commitments with regard to exports, for example. Another common feature in the region is the aim of controlling the dominant power of foreign enterprises through the formation of mixed enterprises consisting of domestic (State and/or private) and foreign capital, and thereby achieving domestic control over the decision-making of such enterprises. In this context the share sought for domestic capital in mixed enterprises is usually 51 per cent, but, given that this share does not automatically ensure effective domestic control of decision-making, certification by the competent authorities of the existence of such control is required in Argentina, Mexico and the Andean Group. Differing methods are used to encourage the establishment of mixed enterprises in Latin America ranging from a legal requirement to transform all foreign enterprises into mixed enterprises, as in the Andean Group, to restricting the application of fiscal and financial incentives to foreign enterprises, as in Brazil.

(x) At this stage it is virtually impossible to evaluate the effectiveness of the various methods adopted to control the dominant power of foreign enterprises, largely because of the fact that most of the relevant laws were enacted only recently. One aspect, however, should be noted, namely the high degree of decentralization of administrative control in respect of foreign investment, which may in certain cases have led to problems of co-ordination of policy by the different competent authorities and to overlapping in activities.

(xi) Nine countries in Latin America have established varying forms of legislation for the control of restrictive business practices in international licensing arrangements. Argentina and Mexico have adopted special laws in this respect, while for the six countries of the Andean Group the relevant regulations are included in the joint regime covering foreign investment. In Brazil, rules governing this matter have been incorporated in the industrial property, foreign investment and tax laws. Although there are differences in form, a central objective common to all the legislation is the control of restrictive business practices and with it control of the monopoly or oligopoly power of foreign licensors. In this context, the laws classify the various types of restrictive clause about which Governments are concerned, and these include such typical restrictions on competitin as territorial limitations, tied purchasing, price-fixing and other types of vertical restrictions. The methods of control, despite their legal appearance, are not based on formal legal concepts and requirements of the kind found in anti-monopoly legislation. The control methods in principle basically follow three approaches with respect to restrictive clauses, namely: (a) absolute prohibition; (b) prohibition in principle, subject to specific exceptions; and (c) optional prohibition at the discretion of the competent authorities. However, in practice, control has been exercised more on a pragmatic basis involving a mixture of strictness and flexibility, rather than on the basis of a strict adherence to any one of these three approaches. As a result of the methods adopted, considerable pressure has been applied to eliminate or modify particular practices in existing and new international licensing arrangements, especially through the power of the competent authorities to refuse registration of such arrangements.

(xii) In the Latin American countries, specific emphasis has been placed on the search for new approaches aimed at controlling the dominant power and practices of transnational corporations. This is particularly evident in the context of two issues, namely, transfer pricing policies and the territorial market allocation arrangements of such corporations. With regard to transfer pricing, the approaches adopted include the enforcement by customs and tax authorities of "arm's length" prices for intra-corporate transactions; the requirement that a detailed justification must be provided of prices charged or paid in cases where "arm's length" prices cannot be readily ascertained because there are no world market prices applicable to the particular transaction; and the requirement that a detailed disclosure must be made of purchases, sales and profits in order to prevent tax evasions. In this latter connexion, mention should also be made of the control exercised in respect of payments for royalties and intra-company loans. In most Latin American countries, royalty payments between related enterprises are prohibited on the grounds that the corporation is regarded as a single entity and therefore not capable of charging itself royalties. Similarly, interest payments on company loans in Argentina are regarded as dividend remittances. In the Andean Group the rates of interest that can be charged on such loans are strictly controlled. Concerning territorial market allocation arrangements, most Latin American countries view with concern any such arrangements which prevent exports. In this regard, many of these countries have sought to establish minimum individual export levels for transnational corporations, an example of this being the provisions in Argentina, Brazil, Colombia and Mexico governing the motor-vehicle industry. In addition, eligibility for tax and other incentives is frequently linked to specific export commitments being undertaken and fulfilled.

(xiii) The control of international restrictive business practices in Latin America has given rise to new legal principles and the revision of previously accepted principles. An important landmark in this respect was the adoption in most Latin American countries of the doctrine of the Argentinian Carlos Calvo that any disputes that might arise out of situations where foreigners were involved were to be decided by the national courts in accordance with national law only. **/ Since that time, however, there has been little development of new legal ideas in this field. Among the most significant ideas, principles or criteria that have recently emerged and that have a direct or indirect impact on the control of international restrictive business practices, the following may be mentioned:

**/ See Black's Law Dictionary, p. 257, and M. Sorenson (Ed.), Manual of Public International Law, New York, 1968, p. 590.

(a) The principle of differentiation in the treatment accorded to enterprises, depending on their economic status and nationality. This is a recognition of the fact that, in terms of Latin America's past and present experience, foreign enterprises usually possess several structural differences and advantages vis-à-vis domestic enterprises. These stem not only from differences in legal status (i.e. the facilities accorded to foreign enterprises to remit capital and dividends abroad and to demand compensation for expropriation under international law), but also from differences as regards economic and organizational structures, such as the size and level of diversification of activities and in the case of transnational corporations the transnational nature of production and marketing systems. National and foreign firms are thus treated differently and the traditional principles of "national treatment" and "non-discrimination" are no longer the accepted rules. There is also, moreover, differentiation in treatment as between foreign firms. This does not mean the establishment of legal discrimination on the basis of the country of origin of the foreign enterprise; rather it is a recognition of the need to take into account in a pragmatic way the differences in the behaviour of foreign enterprises and their differing contributions to the objectives of national development (for example, whether they contribute or not to exports);

(b) The legal principle that subsidiary and parent companies constitute a single unit and therefore cannot enter, as between themselves, into contracts having legal effects. The legal expression of this principle is that no contract can be deemed to exist since there are not two parties to the transaction and the interests of those concluding the contract are not opposing but concurrent or parallel;

(c) A related legal principle which seems to be emerging is that a foreign parent is responsible for its subsidiary's conduct and hence its obligations. For example, the parent may be responsible for financial obligations in the event of its subsidiary's bankruptcy;

(d) The principle that a transnational corporation may be required to contribute positively to the host country's balance of payments, given its capacity to control trade. In this respect, foreign subsidiaries have been required to increase their exports as a prerequisite for receiving foreign exchange for the import of goods, or to increase their domestic sales. Similarly, the share of a transnational corporation in a mixed enterprise may be related to the proportion of the total sales which are destined for export;

(e) The modification of existing legal principles relating to international trade. In this connexion, in a number of Latin American countries the scope of patent rights has been modified, especially with regard to the elimination of exclusive rights over the importation of products which are covered by a patent or a patented process. In addition, the established principle of "arm's length" pricing has been extended to apply to intra-company transactions by transnational corporations.

(xiv) The principal conclusion that emerges from the study would seem to be that no systematic and self-contained policy, aimed primarily at the over-all control of restrictive business practices, could be said to exist in Latin America, either regionally or in the individual countries. What can be termed as a policy to control restrictive business practices is essentially in nearly every country a by-product of a series of government policies in a number of areas. The by-products are not always in harmony with one another, nor do they collectively form a co-ordinated approach to the question of restrictive business practices. This is not a surprising conclusion, especially given the fact that no single accepted school of thought at present exists either in the developed countries or in the developing countries, collectively or regionally, on what practices should be controlled or how best control may be effected. In this context, it is extremely important to recognize the differences that exist between the various countries as regards the fundamental aspects of their economies and institutions, as well as their over-all policies.

(xv) A number of other important general conclusions emerge from the study, and may be summarized as follows:

(a) Governments in Latin America are generally fully aware of the need to control restrictive business practices adversely affecting their trade and development. The study reveals the existence of significant common denominators in the policies and laws of the different countries. However, given the stage reached in the development and implementation of the relevant instruments, especially the more recent ones, it is as yet difficult to derive from them precise legal principles or rules of thumb which might be applied generally in developing countries;

(b) The selection of the specific means for the control of restrictive business practices at the domestic level is primarily a matter of policy choice. The options available should be viewed in relation to such factors as the role of competition in over-all economic policies, the structure of private business, the existence of public enterprises, and the over-all industrial development policies of a country. If a direct system of control of market power through anti-monopoly type legislation is preferred, priority should be given to the question of preventive controls, screening procedures and locating a sufficiently powerful and co-ordinated competent authority at the planning level. With regard to the Latin American countries, it would seem, however, that direct systems of control, based essentially on the laws of the developed countries, have proved inadequate to meet the particular problems found in these countries;

(c) Anti-monopoly legislation in its present form would not seem an adequate means of controlling many international restrictive business practices and, in particular, the dominant power of foreign enterprises in developing countries. Such legislation, in the form in which it exists in the developed countries, seems not to take account of the complex changes which have occurred in international trade and production - in particular the absence of free competition - given the important position held by transnational corporations in such trade and production. Nor does such legislation seem to take into account the differing policy goals of countries, such as the desire for greater national autonomy in the economic development process;

(d) An important determinant in a country's ability to control restrictive business practices would seem to be the extent of its bargaining power. The greater a country's size, growth and resources, the greater its bargaining power and hence the greater its consequent ability to use control mechanisms to enhance and maximize its bargaining position, not only vis-à-vis domestic enterprises but more particularly vis-à-vis the dominant power of transnational corporations;

(e) In the smaller countries of the region, where bargaining power in terms of enterprises and governments is generally weak, emphasis has and should increasingly be placed on the strengthening of bargaining power through regional economic integration as, for example, in the Andean Group, CARIFTA and CACM. The development of common policies and the establishment of a broader market and resource base can make control mechanisms for restrictive business practices more effective;

(f) Some action has been taken in a number of Latin American countries to counterbalance the dominant power of transnational corporations in their economies. One way has been through the creation of State enterprises. Another has been through the creation of multinational regional enterprises and the promotion of the concentration of and mergers between domestic enterprises. With a view to limiting the exercise of dominant power by transnational corporations, a number of countries have actively encouraged joint venture arrangements between domestic (State or private) and private foreign enterprises;

(g) The study indicates clearly the wide range of instruments that can be used to control restrictive business practices at both the domestic and the international levels. The full scope and field of application of some of the new mechanisms adopted have yet to be determined. In consequence, it is not possible to state at this stage whether they are sufficient to meet the control requirements or not. Undoubtedly, gaps exist in terms of coverage since restrictive business practices are many and varied and many will only become apparent as the mechanisms are fully applied, particularly given the ingenuity displayed by enterprises in avoiding or circumventing controls;

(h) Flexibility in the selection and application of the means of control of restrictive business practices would seem generally desirable. The degree of flexibility depends, however, to an important extent on the margin for manoeuvre that exists in terms of national or regional bargaining power. This is not to say that no action should be taken to control all or any of the practices identified as affecting a country's trade and development, but rather that, at the present stage, rigid rules prohibiting all restrictive business practices are more likely to circumscribe a country's ability to exercise its bargaining power and to take effective action than to assist it;

(i) The detection of restrictive business practices is not an easy task for governments, and information, screening and registration procedures must be rigorously enforced if particular practices adversely affecting trade and development are to be detected. Above all, efficient administrative organs are required to apply the laws. Experience in Latin America indicates that, in certain countries, the complexity of some of the new legal instruments has occasionally surpassed the present capacity of the government agencies to enforce them. In these and other countries there would also seem to be an absence of co-operation between the various competent bodies, which could lead to contradictory policies and gaps in terms of the control of particular practices.

(j) Whilst a pragmatic approach to the control of restrictive business practices would seem to be required, effective control would seem to require more concerted government action in terms of policy definition regarding the problems being tackled.

INTRODUCTION

1. This study is concerned with the existing laws and policies in Latin American countries relating to the control of restrictive business practices which adversely affect their trade and development. In this context, acts or agreements between enterprises are viewed in terms of their compatibility with the over-all development objectives of the countries in question and in terms of the legal instruments reflecting these objectives. The study has left out of account, however, agreements specifically arising out of international trade such as national and international export cartels, since they normally escape the present scope of controls in developing countries.

2. The categorization of the different restrictive practices has been undertaken on the basis of the criteria and measures adopted by governments through their relevant laws and policies. In this regard, information collected and analysed in reports and studies regarding the magnitude and implications of restrictive practices in Latin America and other regions has been taken into account. It is somewhat difficult, however, to demarcate each category or type of restrictive practice owing to the evolving and, at times, changing nature of the strategies of enterprises and the techniques used, as well as of governmental policies themselves. Moreover, it is not always possible to find a clear correlation between the control measures and the practices subject to control. For these reasons, the study concentrates on the practices that are of a more typical and readily identifiable character.

3. For the purposes of this study, a distinction has been made between two sets of circumstances: first, where restrictive business practices arise and develop inside domestic markets; and secondly, where such practices arise in the context of international economic relations and essentially originate abroad. This differentiation is an over-simplification of the actual situation, since modern patterns of production and business organization - particularly the geographical diversification of enterprises with the consequent interaction and overlap between economic units and markets - have shaped economic relations in such a way that it is frequently difficult to determine the origin, source and scope of certain decisions and activities. The greater the external links in a country's structure and activity, the greater is this difficulty. Nevertheless, from the standpoint of the relevant laws and policies in Latin America, the differentiation seems an appropriate point of departure. Hence the study is divided in two main parts:

Part One: Control of restrictive business practices arising out of acts or relationships of enterprises at the domestic level (chapters I and II);

Part Two: Control of restrictive business practices arising out of international economic relations (chapters III, IV, V and VI).

4. Chapter I deals with the direct control of market power through laws on monopolies and restrictions of competition. The criteria for the application of these laws, whilst neutral in terms of the geographical source of economic power, are substantially applicable to acts or agreements of enterprises established within national frontiers. These laws are analysed in terms of the methods applied for the determination and control of market power, and the measures taken for the control of different types of restrictive business practices. Chapter II examines the indirect control of market power that can stem from laws and policies relating to price controls; control of market access through industrial development plans; the role of public enterprises in

an economy; industrial concentration; and the protection of industrial property. These instruments belong to different areas of national economic policy but have a common feature in that they are instruments of State intervention with potentially significant influence on the formation and behaviour of economic power.

5. Part Two examines the question of control of international restrictive business practices through restrictive practices laws. Chapter III gives a brief account of the systems of regional control of restrictive business practices affecting economic integration programmes. The substance of the remaining chapters in this part is devoted to the analysis of the instruments of control specifically applicable to different channels for the transmission of international restrictive practices. Chapter IV examines the control of foreign investment and of restrictive practices arising therein; namely foreign domination of national economic activities through the takeover of local enterprises, the use of domestic productive resources and the use of fiscal and financial incentives. The application of the systems of screening and registration of foreign investment and of joint-venture arrangements are considered in this context. Chapter V deals with the control of restrictive practices in international licensing agreements. The control of licensing contracts is first examined in general terms, taking into account the mechanisms of regulation of the material conditions (object, price and duration) and formalities (registration). The analysis then concentrates on the control of restrictive clauses in international licensing agreements, on the basis of a classification of their different types. Chapter VI examines the possibilities for control of the activities of transnational corporations and especially of those practices which are more specifically related to this kind of business enterprises, namely, its pricing policies and territorial market and its production allocation arrangements.

6. The study is primarily based on information collected as a result of field work in a number of Latin American countries during the months of March and April 1974 and updated through indirect sources until the middle of that year. Such information includes: (a) laws, regulations, and administrative and judicial decisions; (b) official reports, documents prepared by administrative or technical entities; and (c) information collected through interviews with the competent authorities, experts and officials of the different countries. This information is complemented by data from other sources contained in different studies and documentation concerning the various subjects covered in this study and to which reference has been made in the relevant parts of the study. Considering the broad coverage of the study and the evolving and changing nature of the laws and policies examined, it is inevitable that some important new instruments and policy orientations will have been introduced to modify and in most cases strengthen existing laws by the time the study is published.1/

7. Before embarking upon the detailed discussion of the control of restrictive business practices in Latin America, it may be useful to refer briefly to the significance

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1/ This has happened in at least two cases since completion of this study: in July 1974 the Chilean Government enacted a new statute on foreign investment and, in October 1974, the Argentine Congress approved a new law governing the question of the transfer of technology.

of restrictive business practices in the region. For many years there was generally no evidence of government concern in the economic policies pursued in Latin America regarding the possibility that restrictive business practices might affect national trade and development. Moreover, to a certain extent, the policies adopted seem to have encouraged and consolidated the use of such practices in a climate of the relatively free exercise of economic power.

Dominant positions and restrictive practices at the domestic level

8. Since the beginning of the industrialization process in Latin America, and particularly with the speeding up of this process as a result of import substitution policies,[2] national economic systems have tended to show structures and situations characterized by a high degree of oligopolization in many sectors, which resulted in significant barriers to competition. The massive and, at times, indiscriminate use of industrial protectionism prompted by balance-of-payments considerations rather than being part of an over-all industrial development plan, encouraged the establishment of numerous enterprises and accelerated the growth of certain sectors, such as the non-essential consumer goods industries, to the detriment of the basic industries sector. Consequently, there was little specialization of productive activities. The over-all effect of this process was the emergence of dualism with serious consequences as between a modern sector functioning below capacity and an atomistic and technically obsolescent traditional sector.

9. The available date for the majority of the countries of Latin America indicate that in the various economies a small group of enterprises controls a large proportion of total production.[3] This has enabled these enterprises to determine, to a large extent, the behaviour of the other smaller units and provided a rather wide field of manoeuvre for restrictive business practices. Since the industrial concentration process did not involve the disappearance of small and medium-size enterprises, it fostered increased relations between the dominant and subordinate, especially through buying and selling arrangements and financial and technical assistance operations.

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[2] See Latin American Free Trade Association (LAFTA), Estudio de la problemática industrial de la zona, ALALC/SEC/8A/17, 1973, p.13 et seq.

[3] For example, in Argentina oligopolistic industries increased their share in total industrial production from 33 to 43 per cent in the period 1953 to 1962. In Chile, nine firms controlled, in 1963, 45 per cent of the share capital of the big industries (firms with more than 200 workers) and 25 per cent of the capital of all manufacturing industries; in Colombia, the 100 large firms owned in 1968 1 per cent of the industrial plants but were responsible for 46 per cent of the industrial production and 28 per cent of the employment in that sector. For further details see E. Cimillo and others, Acumulación y centralización del capital en la industria argentina, (Buenos Aires, 1973); P. Skupch, Concentración industrial en la Argentina, in Desarrollo economico Vol. II, No. 41, (Buenos Aires, 1971); CORFO, El desarrollo industrial de Chile, (Santiago, 1966); S. Ramos, Chile ?Una economía de transición? (Santiago, 1972); Departamento Administrativo Nacional de Estadística de Colombia: Contribución al estudio del grado de concentración en la industria colombiana (Bogota 1972); for Brazil, see "As 200 maiores" en Visão, August 1973.

This encouraged the use of restrictive practices of the vertical type, such as tied purchasing arrangements, resale price fixing and exclusivity agreements.[4]

10. Another important development was the expansion of the larger units through a process of diversification and capital centralization leading to the formation of conglomerates involved in industrial activities, finance, trade and commerce. This frequently led to the accumulation of economic power rather than to any improvement of plant dimensions and scale economies.[5]

11. Another important aspect of the expansion of economic power in Latin America and the strengthening of the pattern of industrial concentration is the question of the ownership and utilization of patents. In general, patent utilization for productive purposes in Latin America is very low,[6] which implies the reservation of local markets for the exclusive benefit of patent holders which are frequently domiciled in foreign countries.

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[4] For details, see Departamento Administrativo Nacional de Estadística de Colombia, *op.cit*. p.72.

[5] For example, in *Chile*, research into the 271 bigger corporations showed that in 60 per cent of the companies, the 10 major shareholders controlled between 90 and 100 per cent of the capital (See R. Lagos, *La concentración del poder economico*, Santiago, 1961). (See also Superintendencia de Companias, *Anàlisis Económico de la Compañia Anónima en Ecuador*, Quito, 1974). A description of different conglomerates in *Colombia* is given in Departamento Administrativo Nacional de Estadística de Colombia, *op.cit*. pp.130-137.

[6] See details about the non-use of patents in Argentina, Colombia, Chile, Mexico and Peru in "*The role of the patent system in the transfer of technology to developing countries*", (UNCTAD TD/B/AC.11/19), para. 273 *et seq*.

Foreign domination

12. The acceleration of direct foreign investment in Latin America in the industrial sector resulted in a situation in which, at the beginning of the present decade, the most important sectors were largely dominated by foreign firms.[7] Foreign capital was invested mainly in the most dynamic branches of industry, reinforcing the oligopolistic structure of these industries.[8] The bigger the size of foreign subsidiaries, the higher was their growth and domination. Acquisition of assets belonging to existing national firms[9] was an important feature of this development especially in the

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7/ In *Argentina*, only 13 of the biggest 50 industrial companies were foreign in 1955, accounting for 43.7 per cent of the total sales of the group. By 1970, the number of foreign firms was 33, accounting for 72 per cent of sales and 13.7 per cent of the total production of manufactures. In *Brazil*, by the end of the 1960s, foreign firms controlled 51.6 per cent of the capital of the biggest 1000 private companies. Among the 10 biggest firms in each of 14 industrial sectors, 73 were foreign, six State-owned and 58 controlled by private local capital. In *Chile*, in the middle of the last decade, foreign firms controlled half of the capital invested in industry and in 61 of the 100 biggest firms foreign capital was predominant. In *Colombia*, 27 of the biggest 100 enterprises were foreign in 1968, and accounted for 32.1 per cent of the sales of these enterprises. In *Ecuador*, almost 60 per cent of the total assets of companies were foreign owned in 1971. In *Honduras*, *Costa Rica* and *Guatemala*, the foreign share of the industrial sector in 1968 varied between 30 and 40 per cent. In *Mexico*, foreign capital was invested in 57 of the 100 biggest industrial and commercial companies in 1972. See for Argentina, P. Skupch, *Concentración industrial en la Argentina 1956-1966*, *op.cit.*, p. 9, and L. Piotrkowski and M. Khavisse, "*El caso de las cien empresas mas grandes*" (Buenos Aires, 1973)(Mimeo); for Brazil, F. Gasparian, *Capital extranjero e desenvolvimiento de América Latina* (Rio de Janeiro, 1973), pp. 128 *et seq.*, and Jornal do Brasil, *Revista Economica*, 18 April 1974; for Chile, CORFO, *Participación del capital extranjero en las sociedades anónimas industriales* (Santiago, 1970); for Colombia, G. Misas, *op.cit.*, p. 124 *et seq.*; for Ecuador, Superintendencia de Compañias, *op.cit.*; for Honduras, Costa Rica and Nicaragua, Permanent Secretariat of the General Treaty for Central American Economic Integration (SIECA), *El desarrollo integrado de Centroamérica en la presente década* (Buenos Aires, 1974), Vol. 4, pp. 59-62; for Mexico, B. Sepulveda and A. Chumacero, *La inversión extranjera en México* (Mexico City, 1973).

8/ For details on the predominance of foreign enterprises in the most dynamic sectors, and on the higher rate of growth of such firms in comparison with the growth of the industrial sector, see F. Fajnzylber, *La empresa internacional en la industrialización de América Latina*, Revista de Comercio Exterior, Mexico, December 1971, pp. 324-338.

9/ A proportion of 35.8 per cent of the United States subsidiaries established in Latin America at the end of the last decade were the result of takeovers. However, the phenomenon of acquisitions in Latin America seems to have been less intense than in other regions. Moreover, takeovers have tended to be more frequent with respect to firms in traditional sectors rather than in modern sectors. See F. Fajnzylber, *op.cit.*, p. 329.

comparatively larger countries,[10] namely Argentina, Brazil and Mexico - where some of the takeovers gave rise to considerable public debate. Even though some of the acquisitions may have resulted from a spontaneous offer of the national owners,[11] in general takeovers were the result of pressures of various kinds over a period of years. Several facts indicate that many of these acquisitions were the logical end result of an all-pervasive process of financial, commercial and technological dependence of national firms on their future acquirers; and that the process was often facilitated, indirectly, by certain governmental measures, such as devaluations, facilities for the foreign supply of local industry, limitations on the remittance of dividends abroad, and promotion of domestic capital markets.[12] The expansion of foreign subsidiaries frequently involved extensive use of local financial resources, rather than the use of external resources. This not only reduced the net capital inflow to host countries, but, an even more important matter, aggravated the difficulties for local firms in obtaining financial support, given their weaker credit standing.[13] Moreover, foreign enterprises were the main beneficiaries of the systems of industrial protection and development applied by the countries.14/ As a result, the objectives of development plans and industrial incentives, based on the idea of protection of "infant industry", were distorted and excessive protectionism fostered productive inefficiencies with high internal prices for the products in question and high profits for a large number of foreign enterprises.

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[10] For example, in the case of *Peru*, takeovers had minor importance as a means of entry of foreign investment, in comparison with the establishment of new enterprises. See E. Anaya, *Perú, diversas formas de comportamiento que asumen las grandes empresas y conglomerados multinacionales en la industria manufacturera*, Lima 1974 (mimeo).

[11] See G. Rosenthal, *The role of private foreign investment in the development of the Central American Common Market*, 1973 (mimeo), p. 360 *et seq*.

[12] See among other reports, for Argentina, M. Sauret, "*La denacionalización del control de la economía argentina y la legislación antimonopolio*", in *Revista del Derecho Comercial y de las Obligaciones*, Buenos Aires, 1970, pp. 349 and 387 (where several cases of transformation of licensing contracts and purely commercial links in stockholdings are described) and J. Mistorell, *Las inversiones extranjeros en la Argentina* (Buenos Aires, 1969); for Brazil, F. Gasparian, *Capital estrangeiro e desenvolvimento de America Latina* (Rio de Janeiro, 1973)(with details about the use of government supported investment funds for financing foreign takeovers); for Mexico, B. Sepulveda, *La empresa transnacional en Mexico* (Mexico City, 1973), p. 69; see also J. Misas, *op.cit*. p. 139, where it is suggested that the Colombian ceilings for profit remittances may have been used to buy national enterprises with the non-remitted funds.

[13] In *Mexico*, 48 per cent of the total assets of foreign enterprises was financed in 1965 from external resources and 52 per cent from local sources. Five years later, these proportions were 36 and 64 per cent respectively (B. Sepulveda, *op.cit*. p. 50). The percentage of funds derived from self-financing and local borrowing with respect to total United States direct investment in Latin America rose from 67 per cent in 1957-1959 to 91 per cent in 1963-1965 (O. Sunkel, *Capitalismo transnacional y desintegración nacional en América Latina* (Buenos Aires, 1972), p. 63. This phenomenon had been facilitated by the penetration of foreign investment in the banking sector. See M. Wionczek, *La banca extranjera en América Latina* (Lima, 1971).

13. An important contributory factor in the foreign domination of industrial sectors in Latin America was and is foreign ownership and control of patents, know-how and trademarks. Because of the oligopolistic conditions in the international markets in terms of access to these elements,15/ foreign enterprises have been able, to a large extent, to dictate the terms of their supply; namely, whether supply should be effected through the establishment of subsidiaries, joint ventures or through international licensing arrangements. A reflection of the dominant power of foreign enterprises and the weak bargaining position of domestic firms in the wide range and number of restrictive business practices included in intra-company agreements and international licensing arrangements, in particular involving restrictions on export; tied purchasing arrangements for capital goods, raw materials and intermediate products and final products; and price-fixing arrangements for products supplied, manufactured or resold.16/

14/ Regarding the application of industrial incentives to foreign enterprises, see B. Sepúlveda, *op.cit.* p. 30, and Techint Organization, *Boletin Informativo*, No. 190, Buenos Aires, 1973, pp. 24 *et seq*. Regarding the possibility of foreign firms having determined or influenced the establishment of certain levels of protection by local governments through the discriminatory setting of prices to local production costs, see C. Vaitsos, *Intercompany income distribution and transnational enterprises*, Lima, 1973 (mimeo).

15/ In the above context, see in particular the report of the Group of Eminent Persons on the Impact of Multinational Corporations on Development and on International Relations (United Nations Publication, Sales No. E.74.II.A.5).

16/ Reference may be made, *inter alia*, to the following studies on the range and kinds of restrictive practices used in licensing contracts in Latin America: "Restrictive business practices: Interim report by the UNCTAD secretariat" (TD/B/C.2/104), and "Restrictive business practices: Report by the UNCTAD secretariat", TD/122 and Supp.1, published in the report and proceedings of the third session of the Conference, United Nations Sales Publication E.73.II.D.5, Vol. II.; "Policies relating to technology of the countries of the Andean Pact: their foundations - a study by the Junta del Acuerdo de Cartagena" (document TD/107, third session); "Major issues arising from the transfer of technology to developing countries" (UNCTAD TD/B/AC.11/10/Rev.1); "Major issues in transfer of technology to developing countries - a case study of Chile" (TD/B/AC.11/20, UNCTAD 1974); Wionczek, M.; Bueno, G.J.; Navarrete, J.E.; "*La transferencia de tecnologia al nivel de empresa. El caso de México*", (Mexico City, 1971); Enrique Aguilar, "*Mexican law of technology transfer and its import on the national economy*", UNIDO, doc. ID/WG.178/7; "*Estudio de los contratos de licencias y transferencia de tecnologia con el exterior*", Instituto Nacional de Tecnología Industrial, Buenos Aires, 1974; Esteban Santana Carrión,"*Los contratos de transferencia de tecnología en el Perú*", Technical Secretariat of the Foreign Investment and Technology Committee, Ministry of Economic Affairs and Finance, Lima, Peru, 1974.

14. Another important aspect which has to be taken into account when considering the question of foreign domination is the question of the structure and position of transnational corporations nationally and internationally. Their structure is important in respect of the location of decision-making and the degree of autonomy of the affiliate. Global strategies of transnational corporations in terms of territorial production and market allocation arrangements, pricing policies and the use and movement of funds have a vital impact on an affiliate's operations. In this latter context it should be noted that in many Latin American countries, the volume of intracompany transactions is substantial and growing, especially in respect of exports and imports of manufactured products.[17] Account should also be taken in this regard of the fact that such trade is largely concentrated in those industries in which oligopoly and monopoly conditions tend to be the most marked.[18] Further, it is in this area that the known cases of abuses in the transfer pricing mechanisms have occurred, especially with regard to the over-invoicing of raw materials, capital goods and other inputs imported from parent companies or other affiliates abroad.[19]

15. Thus, in the discussion in the following chapters of the control of restrictive business practices in Latin America two important factors have to be borne in mind, namely, the generally oligopolistic nature of the industrial structure and the existence of foreign enterprise domination within this structure.

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[17] For example, in Brazil, the subsidiaries of United States based multinational enterprises accounted for almost 35 per cent of Brazil's total exports of manufactures in 1970, whilst imports from their parent companies or other affiliates far exceeded such exports and resulted in a net trade deficit for these enterprises of $352 million in the same year. Likewise, in Ecuador, the most important foreign corporations in 1971 exported 772.5 million sucres and imported goods worth more than 3 billion sucres, the majority of which came from countries of their parent companies.

[18] See in this connexion O. Sunkel, *op.cit.* p. 64; F. Fajnzylber "*Sistema industrial y exportación de manufacturas*", CEPAL/IPEA, 1970, p. 263 *et seq.*, and R. Vernon, Restrictive Business Practices: The operations of multinational United States enterprises in developing countries: Their role in trade and development (UNCTAD), United Nations Sales Publication No. E.72.II.D.18.

[19] One of the first systematic pieces of research on this subject was carried out by the Government of Colombia. The research detected over-invoicing that reached up to 82 per cent of the effective total return of foreign subsidiaries; see C. Vaitsos, *Transfer of resources and preservation of monopoly rents*, *op.cit.* In *Chile*, (see CORFO, *Costos implícitos en la transferencia de tecnología*, 1971); and *Mexico* (see M. Wionczek *et al.*, *La transferencia de tecnología a nivel de empresa: el caso de Mexico*, *op.cit.*) half the cases examined showed over-invoicing of more than 100 per cent and in some cases of more than 1000 per cent. In *Argentina* (see A. Araoz, M. Kamentzky and O. Bourquin, *Estudio sobre el comercio de tecnología*, Buenos Aires, 1971), over-invoicing of certain pharmaceutical products reached, for some items, 900 per cent in the case of United States imports and as much as 4,800 per cent in the case of imports from Switzerland.

PART ONE

CONTROL OF RESTRICTIVE BUSINESS PRACTICES ARISING OUT OF ACTS OR RELATIONSHIPS OF ENTERPRISES AT THE DOMESTIC LEVEL

Chapter I

DIRECT CONTROL OF MARKET POWER AND OF PRACTICES RESTRICTING COMPETITION

16. At least from a formal standpoint, the Latin American countries have given attention to the problem of monopolies and restrictions on free competition for some time. Nearly all the modern constitutions and codes, particularly those drawn up during the 1930s and the early 1940s, contain specific provisions prohibiting the abuse of market power. 20/ These provisions do not, however, reflect any clear policy of State intervention or control as regards the structure of the economy. As a rule, they are included for political and moral reasons, 21/ the argument being that monopolies are incompatible with a liberal democratic system and that the law must suppress them in order to safeguard individual rights, in this case the freedom to engage in business activity.

17. Perhaps the theoretical approach which the Latin American countries initially adopted to competition, basing their legislation largely on that which was in force at the time in the industrialized countries, was one of the factors limiting the subsequent development of anti-monopoly legislation. In any event, although it is mainly in recent decades that the pace of concentration in the region has quickened and that the industrial structure has become characterized by market domination and barriers to competition, in the whole of Latin America, there is at present basic legislation on the subject in only five countries: the Argentine law on suppression

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20/ Mention may be made, among others, of the provisions in Argentina, Law No. 11,210 of 1923; Brazil, Constitution of 1937 and Legislative Decree No. 7,666 of 1945; Colombia, Criminal Code of 1938, arts. 276 and 281; Chile, Legislative Decree 520 of 1932; Ecuador, Constitution of 1946, art. 194; El Salvador, Constitution of 1939, art. 55; Costa Rica, Criminal Code of 1941, arts. 286 and 287; Honduras, Constitution of 1936, art. 63; Mexico, Constitution of 1917 and the Organic Law of 1934 enacted pursuant to article 28 of the Constitution; Nicaragua, Constitution of 1939, art. 39; Paraguay, Constitution of 1940, art. 15; Peru, Constitution of 1933, art. 16; Venezuela, Constitution of 1936, art. 32.

21/ In some cases there is a stronger socio-economic motivation. The Argentine Law of 1923 was partly motivated by the reaction against the foreign packing-house trust which controlled the meat industry, and against a number of local groups which exercised a monopoly over various essential goods. Under the Brazilian Constitution the State could intervene in order to co-ordinate the factors of production so as to prevent or resolve any conflicts, and to introduce the concept of the national interest into the play of individual competition. In Mexico, the relevant article of the Constitution, while liberal in spirit, contains the objective of suppressing any concentration or hoarding of essential consumer goods ... and in general anything which constitutes an undue exclusive advantage for any given entity or entities to the detriment of the public in general or of a social class.

of speculation and monopolies (Law No. 12,906 of 1946); the Brazilian law and regulations on suppression of abuses of economic power (Law No. 4137 of 1962); the Chilean law on protection of free competition (Legislative Decree No. 211 of 1973); 22/ the Colombian Law on restrictive business practices (Law No. 155 of 1959); and the Mexican Law on Monopolies (Organic Law of 1934 enacted pursuant to article 28 of the Constitution). 23/ These laws are examined below.

A. Field of application of the laws

18. The field of application of present legislation in the five countries is considered below from two basic points of view: (a) the definition of market power and the general criteria for its control, and (b) specific control of the various forms of restrictive practices.

1. Definition of market power and criteria for its control

19. Only in two countries, Brazil and Mexico, and to a limited extent also in Colombia, does the legislation appear to regard the concept of market power as a specific prerequisite for State intervention. Nonetheless, even in these countries there are no precise criteria for determining the geographical and product markets or for defining market domination. The legal definitions are based on broad substantive criteria generally related to the possibility of fixing prices and restricting competition. Moreover, there are no cases in which these concepts have been clarified by decisions of the competent national authorities.

20. Even though the legislative provisions either say nothing or are very vague in this respect, the five sets of laws can be classified as instruments basically intended to govern the conduct of the dominant enterprises, rather than their structure. In general, the size of the enterprises and their monopoly position do not in themselves constitute sufficient grounds for State intervention. In some countries the structure of the market is not even a significant criterion. In all of them the existence of natural or *de facto* monopolies is fully accepted; and State monopolies, enterprises with State participation, and sectors specially regulated by the State, either because of the type of activity (e.g. banks, insurance) or for reasons of price control, industrial development or other aspects of government intervention, are generally excluded from the application of the law. Moreover, all the legislations, by establishing procedures for prior authorization or notification based on the concept (also vaguely defined) of efficiency, broadly accept certain acts or agreements restricting free competition.

22/ This Legislative Decree replaced Law No. 13,305 of 1959 without making any significant changes in its substance. The analysis will therefore be based on the experience of the previous law, in view of the short time the new law has been in force.

23/ As will become clear from this study, very few criteria for interpreting the scope and meaning of the legal provisions are contained in court or administrative decisions or in the literature on the subject. There are, however, some valuable studies interpreting the legislation of Argentina and Chile on which this document has drawn, namely the *Tratado de Derecho Penal Especial*, edited by E. Aftalión (Buenos Aires, 1970), and the *Estudio del Título V de la Ley 13.305*, by E. Opazo Brull (Santiago, 1962).

21. Restrictive practices are defined in principle as formal breaches of the law. In other words, it is sufficient to prove that there is a possibility or danger of creating a monopoly situation; it is not necessary for such a situation actually to occur. In Brazil, however, the law seems to require evidence of definite effects of market domination or suppression of free competition. On the other hand, in all these countries, except possibly Colombia, the law requires proof that monopolistic acts were intentional or deliberate. In Argentina article 1 of the Law adds to the concept of monopoly the intention of making a profit. In Brazil, the Law requires an "arbitrary increase in profits" (art. 4).

22. In the Argentina Law, the basic provision (art. 2) covers monopoly in one or more branches of production, industry or transport (by land, air, inland waterway or sea) or in domestic or foreign trade throughout, or anywhere in, the national territory. The Law gives as examples of acts of monopoly the following: acts which impede or tend to impede free competition, or the purpose of which is to achieve an arbitrary increase in profits; market sharing; limitation of production; exclusive-rights agreements; tied-purchasing agreements involving goods or services other than those requested; resale price fixing and sales below cost; the destruction, abandonment or hoarding of production with the aim of increasing prices; partial or total acquisition of enterprises and participation in the management of several enterprises by one person with the object of creating a monopoly, (art.2).

23. In the few Argentine cases in which reference has been made to the concept of market domination, a pragmatic and changing criterion has been adopted. In the Unión de Fabricantes de Especialidades Medicinales case, the court held that collective action by the majority of the manufacturers and importers of patent medicines, controlling almost all the trade in specifics of major importance in the country, amounted to the exertion of undue influence on their part. 24/ In a case of oligopsony (where three large packing-houses simultaneously decreased their purchases of cattle), it was held that in law the degree of control which enterprises may have over the market is immaterial for the purpose of establishing that obstruction to free competition which constitutes monopoly. 25/

24. Lastly, another recent judgement (concerning concentration in the cinematographic industry) appears to justify the existence of dominant positions, stating that the classical theory started from lack of market power, but that today a large enterprise must, if it is to contribute to the general welfare, necessarily have substantial market power. 26/

25. The Brazilian Law and regulations define abuse of economic power as domination of national markets or total or partial elimination of competition (art. 2). Monopoly conditions are defined under the regulations as conditions under which an enterprise or a group of enterprises controls the production, distribution, provision or sale of an article or service to such an extent that it exercises a preponderant influence on

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24/ Criminal Court of Appeals of the Federal Capital, 31 June 1939.

25/ "Compañia Swift y otros", National Economic Offences Court of the Appeals Division III, 2 October 1970.

26/ National Economic Offences Court No. 2, 16 August 1968.

prices (art. 4). An enterprise is presumed to be in a dominant position where a number of firms cannot compete with it in a given branch of business or in the provision of services (art. 3). The Law does not define either the product market or the geographical market (except in relation to national frontiers) nor does enforcement practice make it possible to interpret these concepts.

26. The Brazilian regulations are cautious in dealing with the criteria of action. The conduct of "natural" monopolies is considered abusive only when prices are raised without just cause, for the purpose of achieving an arbitrary increase in profits without expanding production (art. 4). The concern to exercise a certain preventive control over dominant positions is shown by the fact that powerful enterprises are obliged to justify their production costs where there are clear indications that they are charging excessive prices (art. 3), although it is not laid down how they should do so, and by the requirement that acts and agreements aimed at balancing production, regulating the market, stabilizing prices, etc., must be registered and approved in advance (art. 74 of the law). These provisions, however, have so far been completely ineffective, nor has the competent authority called for their enforcement. 27/

27. The Chilean Law is based exclusively on the concept of free competition, and gives as examples, of acts tending to prevent free competition acts affecting production, transport, distribution or prices (art. 2). In enforcement practice there have, however, been a few cases in which reference was made to market structure. In a case of allocation of distribution quotas between the State petroleum enterprise and the subsidiaries of Esso and Shell, the Anti-Monopolies Commission held that if the three companies were to distribute all the petroleum produced in the country as they saw fit, they would be thereby establishing a cartel or monopoly that would prevent any other company formed later from participating in the distribution of petroleum products. 28/ Where an arrangement was made between flour product manufacturers to limit production, the Anti-Monopolies Commission held that the law does not require, in order to apply sanctions, that such arrangements should include all the manufacturers, but only a sufficient number to affect free competition. 29/ Nevertheless, it should be pointed out that in Chile acts restricting free competition are permissible in principle "where they are necessary for the stability or growth of national investments" (art. 4), although theoretically prior governmental authorization is required. 30/

28. In Colombian law a dominant position exists where enterprises, because of the volume of goods or services they control, are in a position to fix market prices (art. 2), and in such a case they are subject to supervision by the competent authority. The general rule, however, does not refer exclusively to situations where market power exists, but to any kind of practice, method or arrangement calculated to restrict free competition or maintain unfair prices (art. 1).

27/ See paragraph 75 below.

28/ Anti-Monopolies Commission, Decision of 7 December 1961.

29/ Anti-Monopolies Commission, Decision of 23 March 1960.

30/ For an account of the only case in which this provision was applied, see paragraph 23 below. For an account of the administrative procedure now applicable, see paragraphs 76-78 below.

29. The Colombian system seems to be directed towards preventive control of dominant positions. In addition, the Law requires prior notification of all "legal-economic concentrations" which involve a given amount of assets; but the Government may object only if they tend to result in an "undue restriction on free competition" (art. 4).31/

30. On the other hand, authorization can be given for the conclusion of restrictive agreements intended "to maintain the stability of a basic sector of the production of goods or services of importance to the general economy" (art. 1). However, the almost total absence of enforcement practice with respect to these provisions would seem to indicate that they have been interpreted rather liberally by the authorities.

31. Under the Mexican Law market power is defined as ability "to fix the price of goods or the cost of services" (art. 30). The existence of a monopoly is presumed, in the absence of evidence to the contrary, in certain cases of concentration and in mergers or situations which make price-fixing possible (art. 4). On the other hand, sales below cost and various forms of unfair competition are presumed likely to lead to monopoly (art. 5). The Law does not define the geographical and technical boundaries of the market.

32. Dominant positions are made subject to State control if they have been created deliberately and are detrimental to the interest of the general public or of some social class (art. 3). Article 4 of the Law also empowers the Government to authorize agreements between firms which permit price fixing or the establishment of production quotas. In Mexico, too, there is no record of government intervention on the basis of these provisions.

2. Specific control of restrictive practices

33. In listing examples of restrictive practices or abuse of economic power warranting intervention by the State, the intention of the legislators seems to have been to cover as wide a range as possible of conduct potentially detrimental to free competition, while giving the enforcement authorities wide powers of interpretation. However, the following analysis will be based on a simple classification composed of three main categories: 32/ (a) concentration and merger of enterprises through centralization of capital or accumulation of directorships in several enterprises; (b) monopolization, i.e. attempts by one or more enterprises to gain or take advantage of dominant positions; (c) horizontal and vertical agreements that restrict free competition.

(a) Concentration and merger of enterprises

34. Most of the legal systems cover different forms of concentration of enterprises, either through the acquisition or exchange of blocks of shares, or through individual mergers or interlocking directorates. 33/

31/ An attempt at "structural" control appears only in the generally applied restrictions on the holding of directorships in various enterprises simultaneously. See paragraph 25 below.

32/ The little enforcement practice makes it difficult to establish a more precise classification of the restrictive practices subject to control. The information available, however, is sufficient to interpret some of the main lines of the different national legal systems.

33/ For an account of the prohibition of some of these practices by corporation law in Argentina, Chile and Colombia, see Chapter II, paragraph 131 below.

35. The Argentine Law includes "amalgamation or merger of capital" as one of the acts which may tend to establish or maintain a monopoly and are punishable by law, and specifically prohibits one individual from acting as director or manager of a number of companies, and direct or indirect acquisition by one company of all or part of the shares of another company (art. 2, l and m). To be illegal, such acts must be aimed at constituting a monopoly, or be capable of restricting or eliminating free competition or abolishing fair competitive prices.

36. There is little enforcement practice, and none of it is very recent. In the "Companía Nacional de Tabacos" case, 34/ where a branch of a foreign enterprise had bought up two local firms, the judge held that "What the law prohibits is pacts, combinations, agreements, mergers and consolidation of capital in order to establish a monopoly, and not the purchase of plants in the same branch of industry. Such an act could never be considered an offence against a law intended to guarantee the free development of commercial activities". In the case of an agreement between two electricity firms, 35/ it was held that the fact that one of the defendants was a director of both firms was not an offence, "which would be committed only if his association with both firms were conducive to a monopoly or to restriction of competition, which in this case it was not". On the other hand, an agreement between two film exhibitors "with the avowed intent of extending their activities in an unlimited way" was held to be conducive to monopoly, in view of the tendency to concentration inherent in that sector. 36/ However, in a more recent case of concentration of cinematographic enterprises, referred to above, the judge dismissed the action on the ground that "The purposes and aims of concentration are different in each historical period, and present-day associations and mergers correspond to material and technical situations which did not exist before and simply had not acquired the importance and magnitude which they have today". 37/

37. The Brazilian Law cites as means of dominating national markets or eliminating competition the acquisition of capital assets or shares of enterprises; incorporation, merger, integration or any other form of concentration; concentration of shares in the possession of one or more enterprises or individuals; and the holding of directorships or managerial posts in more than one enterprise (art. 2, (i) (b), (c), (d) and (e)). No action has so far been taken by the competent authority on any such case, notwithstanding the extent of this list.

38. In Chile the Law does not expressly include acts of concentration among the restrictive practices it mentions. However, the competent authority has twice dissolved groups of companies. One case, previously mentioned, was that of an organization of milling firms created in order to buy up establishments, then halt their production and thus create a scarcity. 38/ In the other case a merger of two

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34/ Criminal Court of Appeals of the Capital, 5 May 1936 (Judgement given pursuant to the earlier Law No. 11,210).

35/ Supreme Court of Tucumán, 16 October 1937 (Judgement given pursuant to the earlier Law No. 11,210).

36/ Córdoba Criminal Court of Appeals, 11 September 1945.

37/ National Economic Offences Court No. 2, 16 August 1968.

38/ Anti-Monopolies Commission, Decision of 23 March 1960.

cinematographic enterprises had "concentrated in the hands of one enterprise the operation of all the cinemas in the city, thus preventing any competition between them."39/ The competent authority has also given advice on various occasions on the legality of projects for mergers or for the acquisition of blocks of shares. In the most important case it decided to authorize the merger of the two largest coal-mining enterprises in Chile, which together accounted for about 80 per cent of the country's production. While recognizing that the merger might impede free competition, on this occasion it took into account the need to rationalize the investments of both companies in order to keep them in business. 40/

39. The Colombian Law, requires by its article 4 prior notification of all proposals for merger, consolidation or integration between enterprises engaged in the same activity, where their separate or combined assets amount to 20 million pesos. If the proposed actions are likely to result in undue restriction of free competition, the Government may, within 30 days object to such proposals. 41/ Once that period has elapsed and the Government has made no objection, the enterprises are free to put their plans into effect. The Law presumes that such restriction will result where the proposed concentration has been preceded by agreements on prices, market sharing, limitation of production, etc., or where market conditions for the particular goods or services are such that the concentration may result in unfair prices. Despite the extensive scope of this rule, it has as yet been applied very rarely. Over the past four years, the competent authority has intervened in about 10 cases of various kinds, and has in each case granted the requested authorization.

40. Article 5 of the Colombian Law also prohibits individuals from holding directorships or administrative or managerial posts in more than one enterprise in the same branch of activity, where the separate or combined assets of those enterprises amount to 20 million pesos or more. It also forbids directors of joint stock companies to distribute, directly or indirectly, goods or services produced by the company or its subsidiaries, or to be partners in the distributing enterprises. It is not necessary, in these cases, that such personal links should tend to restrict free competition. There is, however, only one reported case in which action was taken under this provision. 42/

41. In Mexico concentration of enterprises is not specifically referred to in the Monopolies Law but can be inferred to be one of the presumptions of monopoly affecting any agreement or combination that allows price fixing (art. 3). Moreover, the reference in the Law to the power of the Government to prohibit industrial mergers which constitute a threat of monopoly (art. 12) is very vague. No cases are known in which action has been taken by the competent authorities under these provisions.

39/ Anti-Monopolies Commission, Decision of 13 April 1960.

40/ Anti-Monopolies Commission, Decision of 12 March 1960. For an account of the legal basis of the authorization procedure, see paragraphs 76-78 below.

41/ Before objecting to proposals for concentration, the Government must have prior authorization from the National Planning Department. So far such authorization has not been required.

42/ Decision 005 of 1966 of the Economic Controls Authority. In this case it was proved that various members of the board of directors of an enterprise producing rubber goods held shares in enterprises distributing its products. The authority required the necessary changes in the board of directors.

(b) Monopolization

42. With some differences of emphasis and legislative technique, the law in all five countries seeks to control the practices employed by individual enterprises or groups of enterprises to achieve a dominant position by eliminating competition, or practices constituting an abuse of economic power.

43. In Argentina the basic legal provision prohibits participation "in a consortium, agreement, coalition, combination, amalgamation or merger of capital designed to establish or maintain a monopoly and to profit thereby .... by the mere fact of participation". However, the law does not require there to be more than one enterprise for a monopoly situation to exist. All acts "which hinder or tend to hinder free competition" (art. 2(a)), including acts by individual enterprises, are punishable under the law.

44. Of the various monopoly situations contemplated by the law, the main hypothesis refers to "acts which, through their obstructions of internal or international trade, their prevention of maximum efficiency of production, or their use of devices to prevent fair competition in prices to consumers, thereby increase or are designed to increase, arbitrarily and disproportionately to the capital actually employed, the gains of the person or persons performing such acts" (art. 2(b)). This rule has been applied primarily in cases of price rises, but the defendant enterprises have usually been exonerated because of the difficulty of proving that the profit margins were arbitrary and disproportionate. 43/

45. The other examples of practices defined in the Law as acts of monopoly are more specific: production limitation agreements; abandonment or halting of production; hoarding and agreements not to sell; and sales below cost. In all these cases the Law requires that the practices shall be intended to lead to a rise in prices or to hinder free competition. Experience in application of the rules relating to these forms of monopoly is limited to a few cases of sales below cost, 44/ hoarding, 45/ boycott 46/ and refusal to buy. 47/

43/ Where, in a case tried in 1963, the principal milk producers of Buenos Aires attempted to raise the price of milk, the court found that "There is no reason whatever to suspect an intention to obtain an abnormal profit, or that the agreement involved an intention to make an exorbitant, unjustified, illegitimate, disproportionate, abnormal or unacceptable profit".

44/ Where a land transport undertaking, because of its association with a railway company, was able to charge its users lower rates than did its competitors for both road and rail transport, the court held that, although that policy might bring benefits to shippers and consumers, rates and costs would subsequently rise and that this was indeed the purpose of the operation (Criminal Court of Appeals of the Capital, 8 October 1946).

45/ In two cases of hoarding, the court did not consider that a monopoly existed, because the products were not articles of prime necessity (cited by E. Gómez, Tratado de Derecho Penal, Buenos Aires, 1942, pp. 628 *et seq*.).

46/ In 1937 the Criminal Court of Appeals of the Capital considered that the conduct of a "Union of Cigar Wholesalers" which threatened to withhold certain brands from retailers if they continued to buy direct from a large tobacco company, tended to destroy competition.

47/ In the "Compañía Swift y otros" case, already referred to (see paragraph 23 above), the court considered that the decision of three meat-packing plants not to buy cattle constituted unjustified interference in market conditions by preventing free competition.

46. In Brazil article 2 of the relevant law cites as methods of domination of national markets (apart from the concentration of enterprises already referred to). total or partial cessation of company activities; creating difficulties in connexion with the incorporation or operation of an enterprise and any "arrangements or agreements" having those effects. It is also forbidden to create monopoly conditions by destroying or hoarding production or by other acts designed to raise prices. Discrimination in setting prices or in the provision of services is regarded as abuse of economic power; and in cases of natural or *de facto* monopoly it is forbidden to raise prices without just cause for the purpose of achieving an arbitrary increase in profits without expanding production (art. 2, (ii)), or to suspend production on a large scale without just cause (art. 4).

47. Of the few actions brought by the competent authority on such grounds a considerable number have failed for lack of evidence. The grounds of State intervention have been price rises, 48/ sales below cost, 49/ price discrimination, 50/ reduction of production, 51/ use of improper means (illegal imports) to eliminate competition, 52/ destruction of inputs, 53/ and obstruction of a firm's operation. 54/

48. In the Chilean legislation, the examples given are deliberately formulated in rather broad terms to cover any act intended to eliminate, restrict or obstruct free competition (art. 2(e)). 55/ In one of its most important interventions, involving

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48/ In the two cases of this type, one of the firms charged was acquitted for lack of evidence and the other because it was shown that there was no speculative intent.

49/ In this case, which is still pending, the Brown Boveri Company is charged with attempting to dominate the local market through the systematic dumping of its electric motors and generators.

50/ In one case two glass manufacturers were accused of discriminating among buyers. The proceedings were dropped because it was considered that the purpose of the discounts allowed had not been domination of the market. In the other case, which is still pending, the local subsidiaries of Firestone and Pirelli are accused of price discrimination and of granting bonuses and discounts to some retailers to the prejudice of others.

51/ The cement manufacturers implicated in this case were deliberately operating with idle capacity. The case was dismissed because during the proceedings the market returned to normal.

52/ The case was dismissed for lack of evidence.

53/ In this case, which is still pending, the local Coca-Cola bottling company accuses the local Pepsi-Cola subsidiary of dominating the market through the destruction of bottles and other forms of sharp practice.

54/ In this case the largest Brazilian airline, Varig S.A., was accused by a small company of unfair competition by impeding the supply of equipment and employing improper means of attracting the smaller firm's clientele. The case was dropped because it was considered that the conditions required by the law were absent.

55/ The competent authority has in several cases intervened on the ground of monopolistic practices associated with contractual arrangements, which will be described in the following section.

subsidiaries of foreign enterprises, the Anti-Monopolies Commission defined its position on sales below cost. It stated that a policy of dumping is pursued where increased production and marketing costs are systematically absorbed without raising prices, even where this would be feasible, so as to incur a loss on or to derive only a very small profit from sales when it is known that competitors cannot pursue a similar policy. 56/

49. The Colombian Law prohibits any practices, procedures or systems tending to restrict free competition and to "monopolize distribution" (art. 8). The only specific examples given relate to various situations regarded as "unfair competition". It is specified that enterprises which have their own distribution systems may not sell their products by any arrangement which amounts to unfair competition with independent dealers (art. 7); and also that, where retail prices are fixed by the manufacturer, neither the manufacturer nor an independent dealer may sell at any other price (art. 9). The other examples given are typical cases of unfair competition, such as creation of confusion, with a competitor, the discrediting of a competitor, false statements of origin, etc. No cases are known in which any significant action has been taken under these provisions.

50. In the Mexican Law there is a broad assumption of monopoly in any deliberately-created situation which enables a firm to impose prices for its products or charges for its services (art. 4). More specifically, article 5 defines as acts tending to create a monopoly: sales below cost; voluntary destruction of goods; and sales methods involving unauthorized lotteries or indirect discounts. There are no cases illustrating the scope of these rules except with regard to the control of lottery and indirect discount schemes. 57/

(c) Restrictive agreements and conventions

51. Most of the legal systems reviewed deal with a series of restrictive practices resulting from the conclusion of contracts or arrangements between two or more enterprises operating at the same (horizontal agreements) or at different (vertical agreements) levels of the production process.

52. In Argentina article 2 of the Law covers, among horizontal agreements, price agreements, market sharing and production limitation agreements. So far as vertical agreements are concerned, the Law prohibits exclusive-rights agreements; tied-purchasing agreements involving goods or services other than those requested; or price-fixing, except for products protected by patents or trade marks. What little enforcement practice there is relates mostly to vertical agreements. 58/

56/ Anti-Monopolies Commission, Decision of 2 January 1967. In this case the defendant firm was acquitted because it showed that its low profit margins were offset by the sales of other products and were in part due to the installation of new plant.

57/ Here the authorities confine themselves mainly to ensuring that the prizes offered are genuine and they do not evaluate the possible effects on competition.

58/ Some actions against horizontal price agreement were brought under the earlier law (see footnote 20 above), but it was generally found that the price increases were not punishable as they involved only a fair profit or were not disproportionate, that their purpose was to keep the enterprises solvent, etc.

53. Exclusive-rights agreements have only very rarely been questioned. In one case in which one pharmacy made other pharmacies its exclusive agents in a particular locality, the Supreme Court declared that there was no monopoly "because other pharmacies and the general public could acquire the products they needed from the agents or from any other pharmacy". 59/ In another case certain agreements between salt producers and a marketing firm that gave the latter an exclusive purchasing right and the power to fix the volume and prices of the whole output were held illegal. 60/

54. Sales contracts prohibiting distributors from selling competing products are quite common in Argentina, but the few judicial decisions on this subject have not held that such agreements infringe the monopoly law. Recently, however, the Government charged the Argentine subsidiaries of Pepsi-Cola and Coca Cola with concluding monopoly agreements obliging dealers to sell exclusively one single line of products in return for various benefits and bonuses, thus "distorting the natural behaviour of demand by attaching more importance to the convenience of producers, distributors and dealers than to consumer preferences". 61/

55. Tied sales, or sales subject to the obligation to buy some other product, have been the subject of only one judgement, by which the court acquitted the enterprises accused of requiring buyers of tractors to purchase agricultural implements as a condition of the sale. 62/

56. Imposition of sale prices, particularly of patent medicines, has led to judicial proceedings. The agreements involved were generally regarded as likely to create a monopoly as they raised the prices of articles essential to public health with the object of increasing profits and eliminating competition. 63/

57. In the Brazilian legislation, agreements between enterprises are prohibited if they lead to market domination (art. 2,(i)(a)). It is also considered improper to form an economic group prejudicing buyers' or sellers' freedom of decision by making the sale of a product conditional on the acquisition or use of another product or service, or to engage in unfair competition by requiring exclusive control over advertising or by agreeing beforehand on prices and other conditions when bidding for government contracts.

59/ Supreme Court of Argentina, 10 July 1944.

60/ Criminal Court of Appeals of the Capital, 31 May 1935.

61/ See Presidential Decree No. 1,632 of 1970. The proceedings are still pending.

62/ The National Economic Offences Court of Appeal held on 2 October 1967 that, even if such an agreement had existed it would have been due to the firms' legitimate interest in promoting sales, an interest which is "an inherent part of all business activity".

63/ The legal exception regarding branded goods (art. 2(g)) was interpreted as relating to agreements between individual holders of brand names and the retailers, but not to agreements between holders of brand names collectively and their respective middlemen. (National Economic Offences Court of Appeal, 10 July 1962). See also Criminal Court of Appeal of the Capital, 31 July 1939; High Court of Santa Fé, 14 May 1946. In a case brought against the Argentine Association of Film Distributors the court decided that the admission charges imposed by that monopoly organization in film-renting contracts were unwarranted (Criminal Court of Appeals of the Capital, 3 November 1942).

58. There are only two cases where the competent authority has intervened in respect of restrictive agreements and these relate to exclusive sales. In both cases the same group of three enterprises, which together control most of the national beer market, was accused of making the sale of beer to retailers conditional upon the latter's purchasing their beer and soft drinks exclusively from the members of the group. In the first case, the only one in which judgement has yet been given, the enterprises were acquitted because abuse of economic power was not considered as proven. 64/

59. In Chile the competent authority has had to intervene in certain cases of restrictive agreements on prices, market sharing, rationalization and exclusive rights. Agreements concerning prices have been judged illegal on several occasions, either because prices were fixed by the producers themselves or notified to distributors, "since prices of products must be freely determined in the market by the sole operation of supply and demand". 65/ It has, however, been determined that "in no case can maximum prices fixed by enterprises be regarded as interfering with free competition, since they are on the contrary likely to benefit the consumer". 66/

60. Certain important decisions concerning market allocation have been reported. One of these relates to an agreement between COPEC, the Chilean petroleum company, and the Chilean subsidiaries of Esso and Shell allowing COPEC a 50 per cent share in the distribution of fuel and shares of approximately 25 per cent to each of the other two companies, and stipulating that these products must be sold at similar prices. Although the agreement was a typical allocation of production quotas, which is prohibited by law, the Commission pronounced it lawful since it did not prevent other firms from establishing themselves, and indeed permitted a national firm to exist side by side with two foreign firms which agreed to allow it a larger share of the market and thus helped to reduce prices which, incidentally, were subject to State control. 67/ Another case involved the same enterprises, COPEC, Esso and Shell, to which ENAP, the Chilean petroleum enterprise, undertook to supply its products on a permanent basis. The Commission decided that the restrictive clauses of the supply contract were illegal because they required ENAP to sell all the petrol produced in the country to the three distribution companies. Nevertheless, they remained in force so long as no other distributor recognized by the State existed. 68/

64/ Proceedings were recently initiated against Saab Scania and another firm accused of monopolizing the sale of diesel engines through exclusive concession contracts. Mercedes Benz of Brazil is also being investigated by the Government, because it is alleged to have divided up the market of the area by appointing exclusive sales agents.

65/ Anti-Monopolies Commission, Decision of 23 October 1960.

66/ Anti-Monopolies Commission, Decision of 14 December 1962. The Commission has also held that an illegal price-fixing agreement may exist even if the products involved are governed by official prices (Decision of 28 July 1969).

67/ Anti-Monopolies Commission, Decision of 9 August 1960.

68/ Anti-Monopolies Commission, Decision of 7 December 1961.

61. Rationalization agreements have been declared illegal when they were intended to reduce production. The Commission has ruled that "No system may be set up which tends to limit free competition by a contract to reduce the output of any article, particularly if it meets a vital need". [69]

62. As far as agreements conferring exclusive rights are concerned, the law prohibits exclusive distribution rights where a number of producers entrust the distribution of their products to a single entity or person. The Commission accordingly decided that an obligation imposed by an enterprise on a distributor to refrain from selling similar products of other enterprises did not restrict free competition, since other producers could sell their products directly or employ other distributors. [70] In other cases, however, the Commission imposed a time-limit on the validity of a clause conferring exclusive sales rights (arguing that otherwise the further establishment of enterprises similar to the one benefited by the clause might be impeded). [71] It also ordered amendment of an agreement under which a distributor undertook to sell certain products and prevent the sale of competing products in the premises of his agents, [72] and ruled that competition was restricted where the supply of merchandise was made conditional on the obligation to sell only products of a certain firm. [73] On the other hand, it approved an agreement under which a firm undertook to sell to another firm its entire production over a given period. [74] In a case where sales were made conditional upon the purchase of other products, the Commission held that free competition was not restricted if the system allowed a discount for a complete line, since this benefited the buyers. [75]

63. Other practices which were the subject of decisions of the Anti-Monopolies Commission (negative decisions in some cases) were agreements to abolish discounts, [76] agreements to limit publicity, [77] and the creation of an organization of a large number of producers and dealers to sell their products in accordance with uniform rules. [78]

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[69] Anti-Monopolies Commission, Decision of 30 March 1960 invalidating an agreement between meat producers to reduce output and allocate slaughtering quotas. In another Decision the Commission dissolved a millers' organization in which various firms undertook not to increase their production capacity for a period of ten years, extensible indefinitely (Decision of 23 March 1960).

[70] Anti-Monopolies Commission, Decisions of 6 April and of 4 May 1960.

[71] Anti-Monopolies Commission, Decision of 21 December 1960.

[72] Anti-Monopolies Commission, Decision of 22 December 1967.

[73] Anti-Monopolies Commission, Decision of 9 August 1960.

[74] Anti-Monopolies Commission, Decision of 7 July 1959.

[75] Anti-Monopolies Commission, Decision of 2 January 1967.

[76] Anti-Monopolies Commission, Decision of 25 October 1961.

[77] Anti-Monopolies Commission, Decision of 1 August 1961.

[78] Anti-Monopolies Commission, Decisions of 30 December 1960 and 19 July 1961.

B. Control measures and procedures

64. The five different national laws analysed here clearly belong to the "control of conduct" system which aims to prevent the abuse of dominant positions and restrictions on free competition. 79/ Very limited provision is made, therefore, for measures to prevent the formation or bring about the dissolution of large enterprises or groups of enterprises. Another common approach adopted involves application of the principle of a general prohibition of restrictive practices, which are made subject to specific penalties, without any requirement that they be declared illegal by the competent authorities. Nevertheless, the control systems adopted by the countries concerned present certain important differences as regards the machinery for State intervention, the nature of the penalties applied, etc.

65. In Argentina article 1 of the law provides for the preparation of an administrative indictment by a department of the Executive to which ample powers are given to investigate illegal acts, whether on an accusation by a third party or merely on the basis of suspicion. If the administrative indictment provides strong evidence of illegal acts, the Executive must bring a complaint or a charge before the economic offences court, the appropriate special forum (art. 11). The administrative indictment is prepared by the Department for the Defence of Competition, which is within the Office of the Secretary of State for Trade. In theory such an indictment is required in order for action to be taken but in practice the Executive or private persons have had direct recourse to the court.

66. Under the law the prevention and punishment of the prohibited acts depend exclusively on penal-type sanctions, i.e. imprisonment or fine, which the judges may impose either alternatively or together. Moreover, there is provision for extra penalties such as loss of concessions or privileges, cancellation of legal status, erasure of a company from the Public Register of Commerce and, in the case of individuals, disqualification (art. 3).

67. In Brazil the law is applied by the Administrative Board for Economic Defence (CADE), a collegiate body subordinate to the Executive. 80/ CADE determines abuse of economic power by means of an administrative process laid down by law and initiated after a preliminary investigation has been carried out either *ex officio* or on an accusation by a public body or a private person. In practice almost all preliminary investigations have resulted from accusations by other State bodies or aggrieved companies. Once the administrative process has been completed and the conduct has been pronounced an abuse of economic power, CADE may order the respondents to end the restrictive practice by a certain date, and may also impose a fine. 81/

68. In accordance with the pattern of the law, these measures are supplemented by a registration and prior-approval mechanism which, in theory, governs all acts by and all conventions and agreements between enterprises, of whatever kind, that have the effect of balancing production against consumption, regulating the market, planning

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79/ See OECD, *Market Power and the Law*, pp. 49 *et seq*.

80/ See title II of the regulation giving effect to the law for a description of the organization, duties and procedures of CADE.

81/ If the order is not obeyed, CADE must apply to the court to execute its order and summon the defendant enterprises.

production, stabilizing prices, specializing production or distribution, or restricting distribution (art. 74). The law provides that such acts will be invalid unless registered with and approved by CADE, which is empowered to fine companies which do not submit them. There has not yet been a single case in which this rule has been enforced.

69. In Chile, restrictions on free competition are criminal offences punishable by imprisonment and dissolution of the guilty enterprises (arts. 1 and 3). The new law, however, has substantially modified the earlier system of State intervention by increasing the scope of administrative action. The machinery at present in force replaces the former Anti-Monopolies Commission by a number of bodies among which the preventive and executive functions are distributed: the Provincial Preventive Committee, the Central Preventive Committee and the Supervisory Board. 82/

70. The Provincial Preventive Committees conduct hearings on acts which might contravene the Law, superintend and investigate competitive conducts and apply certain control measures such as temporary suspension of the implementation of agreements on which restrictive practices might be based, and temporary fixing of maximum prices. Appeals against such measures may be heard by the Supervisory Board, which is empowered to order that actions or agreements which it considers contrary to the law be modified or ended, that enterprises be reformed or dissolved, that persons in charge be suspended and that fines be imposed. In addition, it can prosecute those responsible for the restrictive practices, either directly or through a prosecuting office which is responsible for investigating such offences.

71. The Supervisory Board can also play a role in connexion with the authorization of acts limiting free competition which are considered necessary for the stability or expansion of domestic investment or in which public bodies or enterprises with State participation are involved, a case which has previously been mentioned. 83/ Such acts may be authorized by a Supreme Decree after a favourable report has been made by the Commission.

72. In Colombia the law establishes a mixed system in which the principle of prohibition is modified and supplemented by various intervention mechanisms to which reference was made earlier: prior authorization of proposals for merger or concentration and of agreements that restrict competition; a total ban on the holding of multiple directorships; and supervision of dominant enterprises. Enterprises have to report annually to the competent authority on the membership of their boards of directors and must list their executives, so that a check can be made on the holding of any incompatible positions. Dominant enterprises are required to submit every six months to the competent body an extensive list of accounting, financial, commercial and technological data from which the latter must determine whether the enterprises are prejudicing unduly the interests of the particular sector; in which case the authority may oblige them to fulfil whatever obligations it considers necessary for their control (art. 3). It is understood that these supervisory powers have not yet been exercised by the Government.

73. The penalties provided for include withdrawal of shares from the stock exchange, prohibition of the activities of the enterprise, and fines (art. 14). In addition the Executive may fix prices for the products of enterprises, order that restrictive practices be terminated, and place enterprises under special supervision for a certain period (art. 17). The few penalties applied have consisted of fines and termination of activities.

82/ See titles II, III and IV of the law.

83/ Legislative Decree No. 211, article 4.

74. It should be noted that the competent organization has changed three times in the 15 years during which the law has been in force. Control was first exercised by the Ministry of Development, then passed to the Economic Controls Authority and then to the Companies Supervision Authority, whose principal function is the exercise of external control over commercial enterprises. This authority, which is responsible under the law for investigating on its own initiative or on a complaint by any person, actions which may be illegal, and for imposing penalties (art. 13), has not yet established any special department or section for the control of restrictive practices.

75. In Mexico the law, in addition to providing for a total ban on monopolies, establishes a number of presumptions concerning the existence of or a trend towards monopoly, for the purpose of facilitating its prevention. However, no specific measures or machinery to deal with such cases have been established. Where monopoly is proven the Executive is empowered by article 7 of the Law to fix maximum prices and require the sale of products or the rendering of services to the public. Specific penalties consist of fines and the closing of establishments (art. 19).

76. A regulation of 1936 established the procedure to be followed in authorizing agreements between or combinations of entrepreneurs which could fix prices. It lays down the criteria for authorization, all of which are based on very broad objectives ("economic efficiency") and regulates the structure and operation of the agreements to ensure that they are maintained permanently under State control.

77. The Mexican monopolies law is in theory administered by the Ministry of Industry and Commerce. To date, however, no arrangements have been made for implementation or competent authorities established, and there have been no cases of direct enforcement, at least of the substantive parts of the Law. [84]

3. Effectiveness of direct control of market power

78. An analysis of experience in implementing the anti-monopoly laws in force in the region leads to the conclusion - which in a greater or lesser degree applies to all of these laws - that the policy of seeking to control market power through the orthodox mechanism of anti-trust legislation as developed in the industrialized countries, which provided the models applied in Latin America, has not so far been particularly effective.

79. The available information concerning the implementation of the five laws considered here is conclusive. During the combined periods of application of the various national laws since they were first enacted, criminal and administrative penalties have been imposed in fewer than a dozen cases. [85]

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[84] Mexican monopolies law figures indirectly in some economic legislation: for example in the laws on industrial development, foreign investment, etc., which lay down as a criterion for their application, the holding of a dominant position.

[85] In a number of instances the time limits on legal proceedings or penalties have barred their application. In others, State action has been confined to issuing legal opinions, carrying out administrative inquiries and authorizing particular transactions.

80. In Argentina, the law gave rise, between 1946 and 1972, to 56 administrative investigations, 18 criminal prosecutions, 11 suspensions of judicial proceedings and one instance of preventive custody, but there has not yet been a single conviction. 86/

81. In Brazil the competent authority has since its establishment intervened in 49 cases, of which only one was brought "ex officio" and eight by other government agencies. Administrative proceedings were taken in only 13 cases, eight of which were shelved or ended in acquittal. The other cases are still sub judice, and no action has yet been taken against any enterprise. Furthermore, the functions of preventive control of dominant positions and restrictive actions or agreements have not so far been exercised.

82. In Chile criminal proceedings have been brought in only one or two cases, and administrative action has for the most part been limited to the issue of specific opinions regarding the validity of particular acts or agreements.

83. In Colombia the action of the competent authority has been confined to a number of administrative investigations into unfair competition and personal links between enterprises. There is no record of penalties of any significance having been imposed, except in the case mentioned earlier of multiple directorships, where the court ordered the cessation of the restrictive practices. 87/ As the body responsible for controlling concentrations of enterprises, the Companies Supervision Authority intervened in about 10 cases, in all of which authorization was granted. On the other hand, the powers of approval or disapproval of arrangements or agreements that restrict competition have not been exercised and it is believed that the function of supervising dominant positions has also not yet been carried out.

84. In Mexico, which has the oldest law in this field, there are no known cases in which government action has been specifically taken under the regulations prohibiting and penalizing monopolies.

85. The type of restrictive practices which have prompted the rare instances of government intervention, and the criteria applied and approach adopted by the competent authorities, do not appear to reflect the scale or specific form of the monopolistic patterns existing in Latin America to which reference was made in the introduction to this study. Although the existence of a dominant market position is not in itself penalized by law, probably with good reason, the impairment and restriction of competition practised by large enterprises have produced very few instances of intervention, compared with the number of cases in which action has been taken against restrictive practices which, while limiting free competition, do not necessarily affect market structure or arise out of relations or situations marked by economic power. There are very few recorded cases of intervention in rapidly-developing or highly-concentrated sectors of industry, in which obstacles

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86/ In the 23 years during which the previous law was in force, 16 cases were brought to trial and one criminal sentence was executed.

87/ Despite the fact that in such cases there is no requirement that the act be deliberate for it to constitute an offence and that no exceptions of any kind are made, the action by the authority has been confined to giving hearings to enterprises and reporting suspected irregularities.

to access and relations of effective dominance are more frequently to be found. 88/ Rather, a substantial proportion of State action has related to production activities, particularly the supply of goods of prime social necessity such as foodstuffs and patent medicines. In this regard the laws appear to have acted more as instruments for the direct protection of the consumer and the control of particular prices than as devices for controlling the functioning of economic structures.

86. Moreover, the administrative infrastructure responsible for applying national legal standards has not been developed to any significant degree. In Argentina, under whose original draft legislation the administrative organ was to have been headed by an official having the same qualifications as a member of the Supreme Court of Justice, 89/ the monopolies law is currently being administered by a minor division of the Fair Trade Department of the Ministry of Trade with a staff of some fifteen persons. In Brazil, instead of the complex administrative machinery provided for in the regulations, CADE has only two lawyers and two accountants to deal with legal matters pertaining to enterprises throughout the country and to audit their accounts. In Chile the former Anti-Monopolies Commission functioned for a considerable period as an honorary body without an infrastructure of its own. In Colombia, responsibility for applying the law was shifted from one body to another a number of times, and on no occasion was specifically-responsible technical staff appointed. In Mexico there has never been any authority to enforce the law.

87. The situation described, which is patently similar in all the countries, is caused by a complex set of factors most of which probably lie outside the institutional legal system. 90/

88. Historical arguments based on the novelty of the legislation (and the example of United States monopoly law, which was not brought into effect for a number of years) do not appear to have much foundation in the case of most of the countries considered here. The Mexican law has been on the statute book for 40 years; the laws of Argentina and Chile, although they showed considerable vitality (particularly that of Argentina) during their early years, subsequently lapsed into prolonged periods of inactivity.

89. Historical explanations also frequently refer to the irrelevance of the models or systems chosen as the basis for the national laws, which in all cases have been

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88/ In this kind of situation the enforcement agencies often adopt an extremely cautious approach, either because of philosophical or technical considerations relating to the virtues of large-scale enterprises or because of the existence of State regulations which appear to narrow the scope for free competition.

89/ See Aftalión, op.cit., p. 432.

90/ At the same time it is significant that the ineffectiveness of the anti-monopoly legislation is publicly recognized in all the countries and is also expressly acknowledged by the governments themselves without, in general, any attempt being made to explain its causes.

United States statute and case law, adjusted in certain respects. In some instances the authorities themselves have justified the non-application of the law on the ground that it is ill-adapted to the national economic structure. 91/

90. With regard to the actual content of the anti-monopoly laws although some important forms of abuse of market-power, such as those relating to restraint of trade, are not dealt with explicitly, the legal provisions may in all cases be said to have been framed in a very broad and flexible manner and could thus cover a wide range of restrictive practices. From the legal standpoint, their defects of form probably reside rather in the very width of interpretation which they accord to the enforcement bodies, in the type of evidence required, and sometimes in the kind of penalties provided.

91. The breadth of the legal definitions and concepts doubtless reflects in part the lack of precise criteria with which the various legal enactments were originally devised and the legislatures' faith in the subsequent development of a case law. However, the necessary institutional counterpart of such an arrangement - the existence of bodies equipped to play an interpretative role - did not work satisfactorily, either because the laws were applied by cautious and non-specialized judges - as in Argentina and, to some extent, in Chile - or because law enforcement was entrusted to administrative bodies lacking power and material resources or occupying an obscure position in the government. 92/ Although the competent organs are invariably granted wide initiative by the law, they have nearly always acted at the prompting of enterprises whose interests have been harmed or which wished to clarify their legal position.

92. One important factor opposing vigorous application of the law is the complex objective and subjective requirements which need to be fulfilled before action can be taken against restrictive practices. In most cases it is necessary to prove that the alleged conduct was deliberate; moreover, proof is required of the monopolistic or market dominance effects of the action (Brazil); a profit motive or excessive profits (Argentina); social harm or unfair motives (Mexico); and impact on prices (Colombia). In view of the tremendous difficulty, particularly for non-specialized bodies, 93/ of proving the existence of monopolistic behaviour, their excessive caution in interpreting the facts on which they have been called

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91/ In the judgement already referred to, whereby an Argentine judge finally exonerated a group of cinema enterprises accused of monopoly practices, it was held that "The old anti-trust laws are not applicable to the new situations arising in the economy of management and fail to cover or accommodate their effects .

92/ For instance, a Bill was recently introduced in Brazil to provide for the granting of special funds "to publicize the law and CADE, an entirely unknown body" (see Opinião, 22 April 1974).

93/ "The offence of creating a monopoly is relatively easy to describe, but its perpetrators are not easily detected, seldom brought to trial, and never or extremely rarely sentenced. While the reason is really to some extent that the demarcation zone between lawful and unlawful conduct here usually contains grey areas in which good and bad faith may intermingle without penal consequence, the failure to penalize offenders is in fact more often due to the lack of concrete evidence to back up the charges" (National Economic Offences Court of Argentina, Division III, 27 June 1972).

upon to act is understandable. In practice, control over behaviour which is likely to or may constitute a restrictive practice has almost invariably been exercised when that behaviour was beginning to yield results, although it is generally defined by law as a formal or inherently punishable offence. [94]

93. The type of penalties provided by some of the laws may be another negative factor. In Argentina and Chile the application of penalties has probably often been hampered by the fact that they are criminal. Moreover, the fines specified in the various laws are probably not large enough to act as an adequate deterrent. [95]

94. None of the laws, except that of Argentina, has tackled the control of impairment and restriction of competition purely from the penal standpoint. The legislatures have devised criteria and systems designed to exercise preventive control over restrictive practices, either by requiring registration and prior authorization of legal instruments and contracts (Brazil and Mexico) or by providing for hearings and possible legitimation of certain practices (Chile), or for prior approval and supervision of the attainment of dominant positions (Colombia). Almost invariably, however, the breadth of scope and complexity of the procedures provided by the laws to apply this machinery makes it practically impossible for bodies of the standing and operative capacity possessed by the competent authorities in the various countries to put them into effect. At the same time, except possibly in Chile, the control schemes make no provision for informal negotiation with enterprises.

95. The preceding discussion is by no means an exhaustive analysis of the internal factors which might explain the difficulty of implementing the laws designed to exert direct control over market power - in other words, the legal administrative and historical factors present in or underlying the various anti-monopoly laws. Rather, it is an attempt to point out their major logical inconsistencies in face of the basic requirements of laws designed to attain that objective.

96. However, the lack or ineffectiveness of anti-trust legislation in some countries of Latin America should not necessarily be interpreted as a sign of indifference to or approval of market power, just as the existence of such legislation and cases of enforcement in other countries of the region are not a definite sign of restrictive attitudes on the part of the Governments concerned. As will be seen in the following chapters, the reactions of Governments to economic power have traditionally been expressed through media and criteria different from and in many cases opposed to the concept of competition.

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[94] The cautious attitude referred to has been most apparent in connexion with the "natural" or "de facto" monopolies which perhaps constitute the majority of Latin American monopolies; the legislation concerned has taken an ambiguous and conservative approach towards them.

[95] The inability of aggrieved enterprises to obtain compensation by any means other than regular judicial proceedings is a further disincentive.

CHAPTER II

INDIRECT CONTROL OF MARKET POWER AND OF PRACTICES RESTRICTING COMPETITION

97. Among the circumstances and policies which have affected the process of economic development in Latin America during the last few decades, one key factor has been the tendency of States to intervene directly in the regulation of economic relations.

98. In almost every case, the predominant rôle of the State in national economies - the intensity of this rôle obviously varies significantly from one country to another within the region - is not the result of any deliberately formed plan but an expression of what is commonly termed "the mixed economy". The circumstances prompting State intervention range from the need to react to international economic crises or to check foreign capital domination, to the aim of strengthening industrial growth and encouraging the formation of local enterprises.

99. Although it is difficult to measure the degree of State participation in each of the various national economies, such participation is broadly characterized by the use of instruments which have a direct impact on industrial structures and even on the pattern of micro-economic decisions. In this connexion, the instruments of State intervention may be regarded as "indirect" methods for controlling market power. As will be seen below, most of the Latin American countries permanently apply, with a reasonable degree of intensity and scope, such economic policy methods as price control; control of the entry and activities of production units in the various sectors; participation of State enterprises in non-traditional areas, particularly basic industries; and promotion of the growth of national enterprises. In all these areas, the administration of national economic policy necessarily has a considerable impact on economic power relations.

100. This chapter will outline the scope of the various measures and mechanisms applied in the various countries to deal with the fields indicated. It will also include a brief examination of the laws on patents and trade marks which, of course, have by their very nature a considerable impact on the existence and extension of market power in so far as they signify the granting of legal monopolies. This will give at least a broad idea of the main legal factors affecting the control of restrictive practices, from the standpoint of economic relations within the various national systems.

A. Price control

101. Price controls were one of the main forms of State intervention which started in most Latin American countries with the world economic crisis of 1930. The new national constitutions and subsequent special regulations vested governments with relatively broad powers and obligations [96]. Over the year these governmental powers, which in some instances were intended to be applied only temporarily, have tended to become institutionalized and have also become a common feature in all the countries in the region. Today the general acceleration of the inflationary process has led to an intensification of controls and to more detailed methods of enforcement.

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[96] Examples are Brazil (Legislative Decree No. 7666 of 1943, concerning acts contrary to the moral and economic order), Chile (Legislative Decree No. 520 of 1932, setting up the General Commissariat for Staple Commodities and Prices), Colombia (Law No. 9 of 1943 concerning the protection of public consumption).

102. As the following examples show, price control currently constitutes a relatively autonomous discipline, endowed with its own jurisdiction and with agencies directly responsible for enforcement. It will also be noticed that the systems adopted often include the regulation of marketing and supply, thus manifestly encroaching upon direct control of competition, i.e. on the field formally reserved for anti-monopoly legislation.

103. In Argentina, Law No. 19,508 of 1972 vests in the Executive the supervision of production, marketing and distribution for the purpose of forestalling and preventing arbitrary price fixing and harmful practices of every sort that restrict free competion (art. 2). Any act or omission likely to lead to improper price raising unjustified refusal to sell, restriction on selling or the like is an offence in law. The Government applies these powers through the Office of the Under-Secretary for Foreign Trade, which may make rules governing the distribution process, fix price margins and set price ceilings.

104. In Brazil, Decree No. 63,196 of 1968 makes the Inter-Ministerial Council on Prices (CIP) responsible for enforcing the system of price regulations on the domestic market. CIP controls the prices of most industrial products [97] with due regard to the existence of structural market conditions reflecting situations of monopoly or oligopoly and the occurrence of anomalous behaviour in such sectors, enterprises or establishments as may be capable of disturbing the ordinary process of price formation (art. 5).

105. In Chile the system of price control is governed by Decree No. 16,464 of 1968, which gives the Office of the Under-Secretary for Economic Affairs broad powers of continuous intervention with respect to costs, prices, marketing and supply, and the corresponding duty to punish speculation, hoarding, refusal to sell and other such offences.

106. In Colombia, Decree No. 201 of 1974 modified the terms of reference of the National Price Control Board set up in 1968, providing it, in addition to its powers to control and fix prices, with a direct rôle in the planning of production of goods and services, on the ground that only a timely knowledge of domestic production could enable the Board to decide whether a price rise was justified by a change in production costs or whether it was attributable to mere greed for excessive profits or to monopoly conditions. [98]

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[97] Most prices in the commercial sector are controlled by the National Supervisory Board of Supply set up by Delegated Law No. 5 of 1962, the enforcement regulations being embodied in Decree No. 51, 620-62.

[98] Statement by the Minister for Development, 11 February 1974. One of the main bases for the legislation on price control in Colombia is set out in Decree No. 3,0[illegible] of 1966, which states that it is necessary to prevent small groups in certain economic sectors from making undue profits by hoarding and by exploiting monopoly situations or shortages, to the detriment of the level of living of the vast majority of the people of Colombia.

107. The Governments of Ecuador, 99/ Mexico, 100/ Peru, 101/ Uruguay, 102/ Venezuela 103/ and a number of Central American countries such as Costa Rica and Honduras, 104/ also have broad price-control powers.

108. Although price controls are applied mainly to staple commodities, in many countries the production of industrial goods and raw materials is also subject to control. Some products in particular, such as pharmaceuticals, are usually subject to regulations which cover not only price control, but also production conditions and processes, as for example in Argentina, Brazil, Colombia, Ecuador, Mexico, Peru and Venezuela. 105/

109. In some countries control over industrial prices is exercised through supervision of the conduct of the leading enterprises in each sector. In Argentina and Mexico, prices for manufactures are controlled on the basis of a consideration of the costs of the enterprises with the largest turnover. In Argentina, the Government has used machinery for negotiating price agreements for some sectors with chambers of industry; similar "sectoral agreement" machinery is often used in Brazil, where various employers' associations conclude agreements with CIP on price changes.

99/ Decree No. 442 of 1973 entrusted the Ecuadorian Price Control Board with the task of formulating a prices policy and vested it with broad powers to regulate the prices of goods and services in all economic activities.

100/ The 1950 Law concerning the economic powers of the Federal Executive is the basic authority for intervention by the Mexican Department of Industry and Commerce, through the National Prices Directorate, to regulate prices and supply in the domestic market.

101/ Legislative Decree No. 19,885 of 1973, noting the occurrence of "unwarranted price increases ... amounting to speculative acts which must be drastically penalized," established a strict control system covering almost all production.

102/ Through the Productivity, Prices and Incomes Commission.

103/ Through the Ministry of Development.

104/ See *Investing, Licensing and Trading Abroad*, Business International, 1974, Section on Central America, p.9.

105/ Some of the strictest controls on prices of pharmaceutical products are those in Argentina (Law No. 18,691 of 1970); Brazil, CIP Decision No. 22-A-73; Colombia, Decision No. 141 (National Price Control Authority, 1972) and Venezuela under the general powers of that country's Ministry of Development.

110. In general, the competent bodies are legally empowered to use a combination of methods to secure effective price control. Besides the traditional penalties of fines, seizures and closures of establishments, which are common to all the countries, the measures available to the governments include the obligation to place goods produced on sale, 106/ rationing of production, 107/ and expropriation of establishments or goods 108/.

111. Some laws, it should be noted, specifically provide for the use of general economic policy instruments such as the reduction or suspension of import duties, 109/ direct import by the Government, 110/ restrictions on credit or on purchases by the State, 111/ etc. 112/

106/ This measure is provided for in the legislation of Chile (Decree No. 1,379, art.65); Colombia (Decree No. 3,099, art. 1 (h)) and Mexico (Law concerning the economic powers of the Federal Executive, art. 5.1) in cases where products considered to be basic or staple are in short supply or are being hoarded.

107/ This is provided for in the legislation of Brazil (Delegated Law No.4 of 1962, art. 6), Colombia (Decree No. 1,379, art. 1 (g)), and Mexico (Law concerning the economic powers of the Federal Executive, art. 5.2)

108/ Argentine law declares all goods of general public necessity liable to expropriation (Law No. 19,508, art. 26); Chilean law permits the expropriation of establishments which do not maintain a normal rate of production or which engage in hoarding or speculation on prices (Decree No. 16,464, art.66).

109/ In Argentina, for example, the Government may waive import duties when supplies are low or when it may be necessary to stimulate competition on the domestic market (Law No. 19,508, art. 3).

110/ Under Colombian Law, government bodies may import free of duty any commodities which are being hoarded. Direct import by the government is one of the broad powers granted under the Chilean, Brazilian and Mexican Laws. In Argentina, Brazil, Colombia, Mexico and Peru similar measures are facilitated by the activities of State enterprises concerned with marketing staple commodities. See para. 65 below.

111/ The most significant action along these lines occurs in Brazil, where CIP brings pressure to bear by a policy of requiring national banks to refuse credits and rediscounts to enterprises which do not comply with the official price policy, and of bringing such cases to the notice of bodies in the public sector so that they will refrain from any transactions with the enterprises concerned. See para. below. In Argentina a recently introduced programme of voluntary restriction of price increases provided for credit and tax benefits for enterprises covered by the programme.

112/ For example, article 5 of Decree No. 46 of Colombia, includes such penalties as suspension of entitlement to import licences, cancellation of registration of patents and trade marks, and cancellation of operating permits for industrialists.

112. A thorough analysis of experience of price-control systems and of their effectiveness would go beyond the frame of reference of this study. Furthermore, it is hard to determine to what extent certain control systems such as the Argentine and Brazilian practice of government-enterprise agreements on prices tend to promote rather than control the cartelization of certain sectors. It is also difficult to determine precisely how far, in certain cases, the frequent practice of fixing prices on the basis of the costs declared by enterprises may stinulate inefficiency,either in sectors in which competition is oligopolistic - where the most efficient producers can fix their costs at the level of the marginal producers - or, in the sectors in which supply is monopolistic - where prices can be raised or lowered as productivity is reduced or increased.

113. All in all, the durability of control systems over the course of time and the important position which they occupy in national administrative machinery would seem to indicate that, whatever their shortcomings, they have come to be recognized as an unavoidable necessity, since competition alone does not serve to regulate prices satisfactorily.

114. On the basis of the brief account given above, it may also be stated that the various measures and machinery at the disposal of Governments may be used to launch a drive to suppress or prevent certain abuses of economic power. In this connexion, the effectiveness of control systems would appear to depend on the competence and powers of enforcement agencies, 113/ and particularly on the efficacy and scope of methods for assessing the costs declared by enterprises, and also on the existence of a sufficient degree of administrative flexibility and co-ordination in applying certain complementary but probably more effective control measures such as restrictions on internal credit, tariff cuts and the import by Government agencies of products which are the subject of monopolistic practices; all these measures are feasible but have not yet been generally applied in the countries of the region.

B. Control of access to the market

115. The access of outside competitors to domestic markets is a principle that is formally recognized in the Constitutions of most Latin American countries, which guarantee freedom of trade and industry. However, the right actually to engage in economic activities of any significance is normally subject to a number of restrictions which in practice amount to a system of prior authorization and in some cases even entail the express concession of a part of the market.

116. While almost all sectors of any economic significance tend to be subject to government control, it is mainly in the industrial sector, which is usually regulated by general and sectoral laws for the promotion and protection of domestic production that the major control systems are to be found.

113/ The measures taken by CIP in Brazil led it to control even cases of domestic dumping, on the ground that less competition in a sector might lead in the long run to price increases; to refuse to treat expenditure abroad, interest on foreign loans, and management expenses of foreign affiliates as part of costs; to limit expenditure on advertising; and to prohibit, for instance, the scale of certain new patent medicines pending an analysis of their technical characteristics and cost structure, including the cost of imported raw materials (CIP Decision No. 22-A/73).

117. Today the majority of countries in the region have organic laws for industrial promotion: Argentina, Industrial Promotion Law No. 20,560 of 1973; Bolivia, Legislative Decree on Investment No. 10,045 of 1972; Brazil, Decrees Nos. 65,016 of 1969 and 1,137 of 1970; Ecuador, Industrial Promotion Law No. 1,414 of 1971; Mexico, Law concerning promotion of new and necessary industries of 1955 and Laws supplementary thereto; Paraguay Investment Law No. 216 of 1970; Peru, General Industries Law No. 18,350 of 1970; Uruguay, Industrial Promotion Law, 1974. In other countries members of the Latin American Free Trade Association, such as Chile, Colombia and Venezuela, the instruments for industrial promotion are regulated through separate provisions concerning tariffs, taxes, credit, etc. There are laws for industrial promotion in the five countries members of the Central American Common Market, 114/ in addition to a Convention on tax incentives for industrial development aimed at harmonizing the national provisions of the members of CACM.

118. Such systems are the successors of the policy instruments devised by each country to carry out the import substitution process. To some extent they still reflect the rationale of that process, especially as regards the need to stimulate industrial growth by direct incentives (such as tax reliefs, credit facilities or subsidies of various kinds) and to protect "infant industries" especially against foreign competition. The industrial promotion policies currently in force in almost all countries of the region are largely continuing to guarantee captive markets and positions of dominance for beneficiary enterprises especially through tariff protection and quantitative controls on imports.

119. Nevertheless, the majority of the laws mentioned earlier, almost all of which were enacted relatively recently, reflect an important change in approaches towards the industrialization process and in methods of State intervention. The reorientation of the national systems, which in some cases is expressed not in formal legislation but in informal policies pursued by Governments, is partly due to a recognition of the adverse effects of the former industrial promotion system based on large-scale, indiscriminate protection and is particularly evident in the countries of the region with a high or average level of development, where the promotion of industry through substitution has lost more momentum than in other countries.

120. From the viewpoint of this study, the salient feature of the new industrial promotion trends is not the change of approach to the existence of dominant positions and to competition in domestic markets but the adoption of objectives and instruments for programming economic structures and the selective and conditional application of Government incentives and benefits on the basis of the efficiency and qualitative aspects of the type of production promoted. Positions of dominance and monopolistic structures are not rejected - they are in fact usually recognized and even, in some cases, encouraged - but they are made subject to direct regulation by the State so that their economic advantages can be utilized and their social and political disadvantages avoided. The major considerations underlying this "practical" approach to economic power are "the small size of the domestic markets for certain products and the excessively large economic size of plants in relation to those markets, which brings the objective of competition into conflict with that of achieving maximum scales of production ..."115/ Account is also taken of the fact that the desired aim of

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114/ El Salvador, Law of June 1961; Costa Rica, Decree No. 2,926 of 1959; Guatemala, Decree No. 1,317 of 1959; Honduras, Decree No. 57 of 1958; Nicaragua, Decree No. 317 of 1958.

115/ ECLA, Economic Bulletin for Latin America, vol XIV, No. 2, Second half 1969, p. 69.

technical progress "does not always depend in the same degree on the existence of competition". 116/ In addition, the attitude of Governments reflects the aim of promoting the growth of domestically owned enterprises on a priority basis in order to expand their participation in the economy and to ensure that the most important micro-economic decisions are taken by local concerns. The latter subject will be dealt with further in subsequent sections of this chapter.

121. The most important aspects of current policies and trends concerning control of access to markets are as follows

1. Prior authorization for the establishment of new enterprises or the expansion of existing enterprises

122. The installation or expansion of industrial plants, especially within the growth sectors and the basic sectors of industry, generally requires the prior approval of Governments, which evaluate projects in the light of development plans and through specialized organs. The scope and modalities of the investment "licensing" system vary from country to country. In Peru, prior authorization is required on a blanket basis, i.e. for the establishment, diversification or expansion of any industrial undertaking 117/. In addition, one of the provisions specifies that such authorization may involve the granting of the total market in exceptional circumstances to one or more industrial enterprises where this may promote continuous and self-sustaining industrial growth or where it may be justified by reason of economies of scale. 118/ In Argentina, there are three possible modes of access to sectors regarded as basic or having priority; open competition in conjunction with direct bargaining, nation-wide public tender, and special authorization. 119/ In other countries, the prior authorization requirement is imposed indirectly. A case in point is the system of Mexico, where the instruments of industrial promotion, especially the possible use of import controls, and the requirement to obtain approval of manufacturing programmes - which are means of protecting the domestic market and controlling the import of raw materials and components - cover such a broad area that Government authorization is virtually essential for establishing industries of any scale. 120/

2. Rationalization of industrial structures

123. The emphasis placed on the rationalization of industrial structures is one of the key aspects of the new trends in industrial promotion. In contrast to the former objectives an indiscriminate expansion of production capacity - sometimes justified by Governments on anti-monopolistic grounds - the emphasis of the systems currently in force is placed on efficiency in industrial production; the methods used in pursuing this aim generally include more extensive and far-reaching State intervention both at the sectoral level and in units of production, which makes for a high degree of market regulation. Concern for efficiency is reflected in the introduction of new measures and the revision of previously existing provisions.

116/ Ibid.

117/ Law No. 19,262, art. 12.

118/ Law No. 19,262, art. 39

119/ Law No. 20,560, art. 20

120/ See Disposiciones Legales Aplicables en Materia Industrial, Department of Trade and Industry (SIC), Mexico City, 1974. In Brazil, the system of prior authorization is not formally regulated by law but in practice applies for the launching of new undertakings in the sectors of basic industry (particularly iron and steel, petrochemicals, shipbuilding and motor-vehicles) and development of mineral and hydroelectric resources.

124. In some countries, tariff protection tends to be less generalized, being granted on the basis of considerations of cost, price, the integration of inter-industrial relations and the level of international competitiveness. 121/ However, the use of tariff policies to increase external competition does not seem to be a method generally favoured by Governments and in some countries (e.g. Peru) would appear to run counter to industrial policy. Government policy is based mainly on direct control of enterprises and more or less mandatory application of development and sectoral re-organization plans. One of the leading examples of this strategy is the proliferation of sectoral programmes, designed either for basic industry - where priority is given to economies of scale and, therefore to the question of the size of production units, 122/ - or to curb excessive growth in certain sectors, such as the motor vehicle industry, 123/ or to ensure the adjustment and concentration of marginal industries such as textiles and some branches of the engineering industry. 124/ Another characteristic feature of industrial policy, which has an important bearing on access to markets, is the support granted to domestic capital goods industries through legal requirements to purchase domestically made goods and other controls on the use of imported machinery and equipment. 125/

121/ For Brazil and Mexico, see B. Belassa, Estructura de la protección en países en desarrollo, Mexico City, 1972. For Mexico, see also Nacional Financiera - CEPAL, La política industrial en el desarrollo de México, Mexico City, 1971. For Colombia, see La política del Ministerio de Desarrollo, Ministry of Economic Development, Bogotá, 1972, vol. I. In Chile, the Government introduced a general reduction in customs tariffs in early 1974 in order to stimulate the efficiency of domestic production through external competition. In the case of the six Andean Group countries, the objective of the common external tariff established by the Cartagena Agreement is to harmonize the industrial protection systems of the member States with a view to achieving greater efficiency in subregional production.

122/ See, for instance, the plans for the iron and steel industry in Argentina, Brazil and Peru.

123/ See the Argentine régime for adjustment of the motor vehicle industry (Law No. 19,135/71) and the Mexican Decree of 1972 laying down basic rules for the development of the motor vehicle industry. In both these cases, State regulations not only cover conditions of entry but also prescribe the volume and type of production, the number of production units and methods for ensuring the full use of installed capacity.

124/ The methods employed vary from case to case, and especially in accordance with the general policies of the Government concerned. In Peru, for example, the problem of excess installed capacity in the fishing industry was overcome in 1973 by expropriation followed by concentration of all productive units in a single State enterprise, while in Brazil, attempts are being made to reorganize the textile industry with the help of re-equipment incentives, to enterprises granted on condition that they do not increase their installed capacity, prove that they are working at full capacity, and dismantle any obsolete equipment they have replaced (see CDI Decision No. 21, 1972).

125/ Controls on the import of goods "similar to domestically produced goods" are embodied in almost all industrial promotion schemes. See Argentina Industrial Promotion Law, art. 3 (i), and Law No. 18,875 of 1971; Brazil Legislative Decree No. 37/66, art. 17 and Decree No. 61,574/67; Mexico, Law concerning development, art. 14; and Peru, Regulation giving effect to the General Industries Law, chapter XXIX.

3. Negotiation of conditions of entry through a system of contracts

125. In order to facilitate the selection of investments and of incentives to encourage them, a number of countries have established a system of agreements between the Government and enterprises, which permits subsequent planning and monitoring of the latter's activities; enterprises undertake certain commitments with regard to minimum plant sizes, proportion of domestically produced parts or components, choice of technology, volume of exports, maximum prices, etc. 126/

126. The first point to emerge from the foregoing review is the relatively limited use which the Latin American countries are currently making of competition as a means of allocating productive resources. While development plans and government policy instruments are increasingly based on concepts and techniques of planning, industrial rationalization and joint public and private operation of units of production, the notion of competition is not mentioned either in legislation as such, 127/ in statements of the grounds for such legislation or in subsequent administrative regulations, except in terms of the aim of improving the ability of enterprises to compete in the international market (which can usually be achieved only through the existence of monopolies in the domestic market).

127. As has already been observed, however, the acceptance of restrictions on competition and limitation of the activities of enterprises occupying a dominant position in the domestic economy does not denote a passive attitude towards abuses of economic power. In fact, current methods of State intervention clearly take the existence of dominant positions into account and are designed to prevent or eliminate abuses or to modify the behaviour of dominant enterprises by exercising direct control over them, by-passing the legal formalities of anti-monopoly legislation and replacing the basic concept of competition as a means of achieving technical progress by the broader, but more concrete notion of efficiency. For instance, a number of abuses which may arise from the oligopolistic organization of markets can be controlled by making it obligatory for each firm to plan its output 128/ and by applying specific measures such as limitations on advertising expenditure (one of the bases of competitive capacity in sectors such as the motor vehicle industry, where a number of different models are produced 129/). Likewise, in the case of monopoly markets or markets in

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126/ This contract system appears to be envisaged as a legal requirement in Argentina (Law No. 20560, art. 21) and is currently being used by the Industrial Development Council in Brazil and by the Department of Industry and Commerce in Mexico. The latter body normally requires enterprises to undertake not to raise domestic prices to more than 15 or 25 per cent above international prices.

127/ The main exception is the Industrial Development Law of Ecuador, which specifies that benefits shall be forfeited in cases where an enterprise employs unlawful means to prevent the establishment of competing enterprises or methods incompatible with fair competition in prices and quality in order to hamper their operation and in the case of mergers of enterprises or the conclusion of agreements on production, pricing and distribution policy between enterprises where the said mergers or agreements may be prejudicial to consumers or to the national interest (art. 5). However, these provisions do not appear to have been put into effect to date.

128/ Further on in this study, reference will be made to the Government device of making the internal expansion of enterprises conditional upon an increase in their exports. See chapter 5, para. .

129/ Provision for this exists in Argentina, Brazil and Peru, based on price control machinery or tax arrangements.

which, by reason of the size of units of production or the position occupied by such units in the production process, economic power is highly concentrated, intervention by Latin American governments is tending to replace private participation by the participation of State enterprises which are wholly Government-owned or in which the Government has a controlling interest.

C. The function of public enterprises

128. Although the economic systems of Latin America, as generally in the non-socialist countries, are based in principle on private enterprise, the particular characteristics of Latin American industrial development have gradually led governments not only to regulate the structure and functioning of the private sector fairly strictly but also to participate actively and directly in the production of goods and services through decentralized bodies and public enterprises.

129. The origins of this practice go back quite a long way. Latin America, like Europe, has a long tradition of State monopolies in the public services and economic infrastructure sector. In the course of time, various, sometimes conflicting circumstances such as international economic crises, the absence of private capital for certain projects or reluctance by private enterprises to undertake them, the desire to achieve industrialization and to defend national economic sovereignty have led to the expansion of State participation and its penetration into other sectors. This process gained momentum for a while during the period of isolation caused by the Second World War, and now seems to have received fresh impetus in a number of countries in the Latin American region.

130. The current importance of public enterprises in Latin America can be gauged from the figures indicating their share in capital formation, gross product, and employment in major enterprises as a whole. 130/

130/ In *Argentina*, nine public enterprises accounted for 43 per cent of the total sales of the 30 largest enterprises in 1969 and five public enterprises were among the 10 largest enterprises in 1972 - see *Revista Mercado*, August 1970 and August 1973. In *Brazil*, eight public enterprises accounted for 31 per cent of the sales of the 25 largest enterprises in 1971, and in 1972 five public enterprises were among the 10 largest enterprises, as in Argentina; moreover, 63 per cent of the liquid assets of the 200 largest enterprises were controlled by State enterprises - see *Revista Visão*, August 1973. In *Chile*, 202 State-controlled enterprises accounted for 22 per cent of the gross value of industrial production in 1972 - see *Panorama Económico*, No. 278 (Santiago, Chile), July 1973. In *Mexico*, the State was, in 1972, a majority shareholder in nine of the 60 largest enterprises engaged in the production of consumer goods and a minority shareholder in 10 of them. In *Paraguay* 13 State enterprises were among the 23 concerns with the largest sales in 1972. In *Peru*, public enterprises accounted for 17.8 per cent of total national investment and 40 per cent of public investment in 1973. (For Mexico, Paraguay and Peru, data from a survey on public enterprises in Latin America currently being conducted by INTAL have been used). For a general survey of this subject, see ECLA, "Public enterprises: their present significance and their potential in development" (E/CN.12/872).

131. Furthermore, State business activities - leaving aside traditional public services, which are generally the preserve of semi-centralized bodies - tend to be concentrated in industrial infrastructure, the production of basic inputs and raw materials, and, in quite a number of cases, various branches of the dynamic consumer goods industry.[131] The growing participation of State concerns in marketing, both at home and abroad, is also significant. In Peru, State enterprises hold a monopoly of the export of various commodities and the import of industrial inputs.[132]

132. The accumulation of economic power in the hands of the State is tending to be formalized through the establishment of large holding companies or conglomerates for State financial, administrative or sectoral enterprises.[133]

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[131] In Argentina, Brazil and Mexico, the State has the monopoly of or dominates rail and air transport, electric power production, petroleum extraction and refining, certain branches of the petrochemicals industry, iron ore mining and the steel industry. In Chile State enterprises have majority control of the production of petroleum-based and coal-based intermediate goods, the basic chemical and metals industries and some finished consumer goods, such as textiles. In Peru, basic industries reserved to the State include sectors such as cement, paper, fertilizers and machine tools; in addition, large public enterprises have been established in the petroleum, steel, fisheries, mining, air transport and industrial marketing sectors. The steel industry in Bolivia and Venezuela, the petroleum industry in Bolivia, Colombia, Ecuador and Venezuela and cement manufacture in Paraguay are other examples of intensive participation in basic sectors by public enterprises. For further details and some figures indicating the percentage of participation in these sectors, see ECLA, op. cit. and INTAL, op. cit.

[132] Legislative Decree No. 19,031 reserves for the State the right to import essential inputs for basic industry and these are currently being imported by the national industrial marketing enterprise established by Legislative Decree No. 19,023 of 1971. In Argentina, Decree No. 1,798 of June 1974 empowered the National Supply Corporation to import raw materials and inputs required for the production of indispensable goods. Other examples of public marketing enterprises are the National Supply Authority and the Brazilian Storage and Trade Corporation in Brazil; the Agricultural Marketing Institute in Colombia; and the Compania Nacional de Subsistencias Populares in Mexico.

[133] In Argentina, the Dirección de Fabricaciones Militares covers 17 enterprises whose activities range from forestry to steel production; the Corporación de Empresas Nacionales was recently set up to control and co-ordinate the activities of the remaining enterprises in the public sector. In Brazil, the National Development Bank has holdings in numerous firms. Two new holding companies - PETROGUISA and SIDERBRAS - have been set up to co-ordinate the various public enterprises in the petrochemical and steel sectors. Other notable examples of this type of State conglomerate are the Production Development Corporation in Chile, which has been directing and managing that country's more important industrial schemes through its subsidiaries since 1939; the National Finance Corporation of Mexico, which has a controlling interest in more than 30 major enterprises, some of which, like Altos Hornos de México, are themselves at the head of sectoral groups; the sectoral holding companies in Peru, such as SIDERPERU, PRESCAPERU, MINEROPERU and INDUPERU, the Industrial Development Institute and the petroleum enterprise ECOPETROL in Colombia; the Development Finance Corporation in Ecuador; the Bolivian Development Corporation; the Venesuelan Petrochemicals Institute, etc.

133. It is not always clear from the foregoing how far the activities of State enterprises represent a policy of permanent State participation in particular sectors (except where these sectors are made into monopolies by the Constitution, by special legislation or through nationalization, nearly all the instances of which have been in the mining and public services sectors). It is even more difficult to establish the extent to which public enterprises take market power considerations and criteria into account in their operations.

134. In some countries government programmes aim explicitly at dominating sectors which are considered politically and economically strategic. The principal example of this is Peru, which has launched a programme for the gradual acquisition by the State of all enterprises in the basic industries sector, based on a division of the national economy into the following areas: public, public welfare, mixed and private. 134/ Other countries such as Argentina, aim at safeguarding the decision-making power of the nation and preventing the emergence of private monopoly structures which affect prices or distort the market; 135/ in Chile the State considers it vital to reserve to itself the principal national industries because of the power which they represent, the indirect benefits which they generate and the contribution which they necessarily make to the economy in general. 136/ In Mexico various items of legislation, such as the regulations for the petroleum and petrochemicals industries and for the development of mineral resources, and also the law on foreign investment, give State enterprises permanent control of various basic sectors. 137/

135. In a second group of countries the objectives of State participation in basic national economic activities have been less clearly defined. For instance, both the National Development Bank of Brazil and the National Development Institute of Colombia possess large shareholdings in basic industries and have behaved as typical instruments of industrial promotion through their many activities designed to put major concerns into operation as a prelude to transferring them to the private sector. This kind of approach has also been adopted by the Development Finance Corporation of Ecuador. There are on the other hand clear indications of a general trend towards acquiring and maintaining State predominance in certain industries; of particular significance is the relationship between governments and foreign capital in new enterprises set up in basic sectors such as petrochemicals, steel and mining. Enterprises such as PETROQUISA and Vale do Rio Doce in Brazil, the Venesuelan Petrochemicals Institute and the Colombian

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134/ Legislative Decree No. 19,453 of 1972. The public welfare sector was regulated by Legislative Decree No. 20,598 of 1974.

135/ Art. 4 (c) of Decree No. 592 of 1973 establishing the national petrochemicals programme.

136/ CORFO, Instrumentos de política económica aplicados en el sector industrial (Santiago, Chile, 1970), p. 4. In addition, the State decides whether to join with private industry in all activities which, because of their size and the small extent of the domestic market, have a monopoly character and, in order to survive in a sound financial condition, require preferential treatment that implies some sacrifice on the part of the community (ibid.). The policy of direct participation by the Chilean State is the outcome of a long and uninterrupted process which has continued under Governments of varying tendencies.

137/ The Legislative Regulations on the Petroleum Industry, 1958, promulgated under article 27 of the Constitution; the Petrochemicals Order made under them, and the Legislative Regulations on Mineral Resources Exploitation and Development, 1961, also promulgated under article 27 of the Constitution.

Petroleum Enterprise generally follow a policy of taking a large enough shareholding in new projects to enable the State to exercise internal control over the companies established. This important aspect will be further examined in a subsequent section of this study dealing with actual experience in the exercise of State bargaining power. 138/

136. In addition to their explicit or implicit aim of replacing private enterprise in sectors in which economic power tends to concentrate, or sectors considered to be of crucial importance for national development, Latin American Governments are in a position through the market power and the organizational structure of State enterprises to play a strategic role in regulating market conditions. This can be done either through control of the supply of basic inputs for industry from such enterprises, or through control over purchase of goods and equipment by such enterprises for their own activities, or through the creation of increased competition in oligopolistic sectors of the economy. Although there is no precise information about the way in which Latin American public enterprises pursue this kind of activity in practice, the sectors in which they operate in various countries undoubtedly make them an important means of controlling the abuse of dominant positions in the private sector, through knowledge and direct control of costs and price formation, supply conditions and demand for specific products. Furthermore, the aforementioned tendency for State economic power to be concentrated and rationalized through State corporations or holding concerns constitutes a significant possibility for increasing the bargaining power of the State and enabling it to act as a counterweight to dominance by private enterprise.

D. Policies for the concentration of enterprises

137. From the legal standpoint, there are no major obstacles in the Latin American countries to the concentration of enterprises coming under national jurisdiction. Such concentration, normally effected by the acquisition of blocks of shares, has been favoured not only by the passivity in the area of existing controls on monopolies 139/ but also by the widespread acceptance of bearer shares, favourable tax régimes and the lack of registration requirements. However, the failure of the State to intervene in this area seriously distorted the concentration process, which was left dependent on the initiative and relative bargaining power of private entrepreneurs. Thus, the concentration of enterprises has typically taken the form of absorption of small enterprises by large concerns and the centralization or decentralization of companies, often for tax reasons, without the aim of greater efficiency ever necessarily entering into such operations. 140/

138/ See, in particular, part two, chap. IV.

139/ See chapter I, para. 65 *et seq.*

140/ As has already been observed, the lack of Government controls and registers makes it impossible to obtain statistical information concerning ways and means by which the concentration process operates in Latin American countries. There are, however, some grounds for believing that concentration has often not been effected with the purpose of achieving more efficient use of the factors of production. For instance, a study on *mergers of companies* in Argentina - such operations account for only a small proportion of acquisitions of shares but are registered by the General Inspectorate of Corporate Entities - shows that most of the 117 mergers recorded during the last six years involve reorganizations of enterprises already belonging to the same group for the purpose of improving their tax position. See J.E. Bustamente, "Reorganización de empresas: fusión de sociedades", in *Derecho Empresario* (Buenos Aires, 1974).

138. As was seen earlier in this study, the new industrial policy trends in Latin America do not reflect any hostility towards enterprises of larger scale. The new approach, which is still in its early stages, appears to be favourable towards economic power provided that it promotes greater efficiency and conforms to national development objectives. In this connexion, a number of measures have been taken for the purpose of stimulating internal growth and encouraging the concentration of domestically owned enterprises. For instance, several countries grant preferential treatment to such enterprises under their general industrial promotion schemes. This subject will be examined in greater detail in chapter IV, 141/. There follows a brief description of a number of specific policies and instruments recently brought into effect by some countries with the aim of promoting the concentration of enterprises on a selective basis.

1. Incentives to concentration of enterprises

139. In Argentina, various measures to promote the concentration of enterprises have been introduced. The Corporation for the Development of Small and Medium-Sized Enterprises set up in 1973 is required to implement plans for the grouping and concentration of enterprises at the horizontal and over-all levels. 142/ The policy measures adopted with respect to certain sectors, such as the régime for the motor-vehicle industry, have similar aims. 143/ At the fiscal level, real action to promote the rescaling of enterprises began in 1970 under Law No. 18,527, the preamble to which refers to the need to facilitate these processes of reorganization and thus prevent fiscal motives from obstructing those market forces which tend to optimize the efficiency of factors of production. The present profits tax Law grants substantial incentives for the concentration of enterprises. 144/

140. In Brazil, the main instrument for promoting the concentration of enterprises is the Committee on Mergers and Consolidation of Enterprises (COFIE) set up under the Ministry of Finance by Legislative Decree No. 1,182 of 1971. The factors taken into account by COFIE in considering applications are economies of scale, the winning of foreign markets and the strengthening of the capital market.

141/ See chapter IV, para. 230 *et seq.*

142/ Law No. 20,568 art. 3, II.2.

143/ See above, foot-note 104. The aim of the motor-vehicle régime is to secure a concentration of the motor-vehicle and spare-parts industries so as to ensure maximum efficiency of production with maximum economies of scale (art. 1 (c)). To this end, provision is made for special loans for the spare-parts industry (art. 50.1), and authorization to establish new enterprises producing finished vehicles is denied except in cases involving the merger of existing enterprises (art. 13).

144/ The profits tax Law (No. 20,628 of 1973) provides that, where companies are re-organized through merger, the division of one enterprise into two or more enterprises, or transfers between entities forming a single financial group, any gains resulting from such re-organization shall not be taxed, provided that the successor entity continues, for a period of not less than two years, to engage in the same activities as were carried on by the re-organized enterprise (art. 76). In addition, fiscal entitlements and obligations such as tax losses, unpaid balances in respect of tax re-assessments and unused tax exemptions are transferable to the successor entity (art. 77).

141. The Brazilian system, although limited to mergers effected through the absorption of an enterprise or the establishment of a new company, is of particular interest because it extends to all sectors of the economy and involves the granting of incentives, thus differing from the Argentine system of open and indiscriminate tax incentives. 145/ On the basis of data up to mid-1974, it is estimated that some 60 per cent of the mergers authorized involve concerns in the banking and insurance sectors, for both of which COFIE has established special rules. 146/ During its first three years of existence, COFIE authorized rather more than 50 concentration operations and rejected some 40 applications. In theory, the system can be applied to foreign-owned enterprises, although in practice an effort is made to ensure that, in such cases, Brazilian investors are not absorbed into or lose control of the re-organized enterprises. Some 20 per cent of the operations authorized involved foreign concerns. The Industrial Development Council (CDI) has arrangements for granting substantial incentives for merger schemes involving firms operating in priority sectors. 147/

142. In Mexico, promotion of the concentration of enterprises is the subject of a decree of June 1973, which refers to the creation of "industrial promotion units", i.e. economic units which promote national industrial development and consist of a development promotion company and one or more promoted companies (art. 1). The decree provides that such units must not displace small or medium-sized enterprises which are operating satisfactorily, nor may they hold a monopoly position to the detriment of the public in general or of any social class, but the principal aim is to encourage enterprises to take advantage of economies of scale by grouping together. 148/ To achieve this, the development promotion companies must invest not less than 75 per cent of their capital in the stock of industrial or tourism enterprises and must control not less than half of the capital of the "promoted companies". In order to ensure that the system works

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145/ Basically, the benefits granted consist in allowing fixed assets to be revalued up to their market value and exempting the resulting capital gain from income tax; in addition, annual depreciation continues to be based on former valuation.

146/ These incentives are one aspect of Brazil's policy of forming large financial conglomerates in order to strengthen the credit system and equip the capital market to meet the financial requirements of industrial producers: between 1950 and 1971, the number of banks dropped from 402 to 150 (Conjuntura Económica, January 1973).

147/ These incentives are provided for in CDI Regulation No. 5. The Council sometimes makes the grant of its incentives conditional upon the merger being within the sector to which the applicants belong. See, for example, Decision No. 19/72 on the pharmaceutical industry.

148/ The principal benefit conferred by the decree, concerning the application of which no information is yet available, is that total taxable income is assessed on the entire group of enterprises, and profits or losses accruing to the promotion unit from sales of fixed assets between enterprises belonging to the group are discounted.

effectively, the decree requires each group of companies to furnish proof that its sales and services are increasing at a rate of 20 per cent higher than the index of industrial growth. The system applies solely to companies whose capital is Mexican-owned.

143. A number of other countries have also adopted legal provisions designed to encourage the concentration of enterprises - inter alia, the Chilean provisions on complementary industries 149/ and the Peruvian incentives to reinvestment of profits in shares of other enterprises. 150/

2. Restrictions on the concentration of enterprises

144. Just as acceptance of restrictions on competition in the new Latin American policies does not imply freedom to exercise dominant positions, so promotion of the concentration of enterprises is usually accompanied by corrective measures of various kinds. The main object of these measures is not always to control or curb the establishment or pattern of activity of large enterprises. They are the outcome of legislative efforts aimed either at modernizing the organization and operation of business concerns, or at promoting the formation of capital markets or introducing methods of State participation in enterprises. However, all these measures also have the secondary objective or indirect result of controlling or reducing undue centralization of economic power within enterprises, without necessarily affecting the position which they occupy in the market.

145. Some measures are designed to protect the rights of minority shareholders and third parties against groups holding a controlling interest in companies. Rules restricting certain methods of forming groups of companies have recently been introduced into the company law of Argentina, Chile and Colombia. The principal rules concern the prohibition or limitation of cross-shareholdings, 151/ restriction of the number of directorships which any one person may hold in different companies, 152/ limitation of the extent of, or the right to, participation by one company in another, 153/ and supervision of transactions between related companies. 154/

149/ Under article 30 of Law No. 13,305 of 1959, as amended by Law No. 16,773 of 1968, inter-enterprise transfers and services may be exempted from sales and services taxes where one enterprise holds not less than 10 per cent of the other's capital and the object of either enterprise is to complement the industrial activities of the other or jointly to exploit capital, patents or technological processes.

150/ Regulations made under the General Industrial Law, chapter VI. The Income Tax Law establishes special treatment for mergers between companies forming part of the same branch of economic activity. In addition, the Peruvian Government has introduced special incentives to promote mergers in certain sectors, e.g. fisheries and tourism.

151/ Argentina, Law No. 19,550 of 1972, art. 31; Chile, Decree No. 251, art. 121; Colombia, Commercial Code, art. 262.

152/ Chile, Legislative Decree No. 251, art. 96; Colombia, Commercial Code, art. 202.

153/ Argentina, Law No. 19,550, art. 31; Chile, Law No. 17,308 of 1970, art. 2.

154/ Argentina, Law No. 19,550 art. 66; Chile, Decree No. 251, art. 121; Colombia, Commercial Code, art. 265.

146. Other measures are designed, directly or indirectly, to democratize the capital of large enterprises. One of the most important systems is the Brazilian legislation on "open-capital companies", which grants tax incentives to joint-stock companies whose shares are gradually taken up by a minimum number of shareholders until they account for 49 per cent of the capital. 155/ Other instruments of this type include the previously mentioned Mexican decree concerning industrial promotion units, which provides for stock-exchange dealing in shares of the groups of companies promoted under the decree, and the Ecuadorian Industrial Development Law, article 24 of which establishes additional incentives for companies in which 45 per cent of the capital belongs to 100 or more shareholders. 156/

147. Finally, one of the most interesting innovations, because of the possibilities which it offers of developing "counterweight powers" within large enterprises, is the Peruvian legislation concerning "workers' communities". This system provides for the mandatory distribution of a certain percentage of an enterprise's profits to its employees and the subsequent reinvestment of these profits in the stock of the enterprise up to the point where the workers' communities hold a 50 per cent share in the capital and management of companies. 157/

E. Industrial property legislation

148. The central characteristic of industrial property is the conferring by Governments of exclusive rights on the holders of such property in respect of its use. For instance, the granting of a patent means, in principle, the concession of a monopoly for the manufacture, use, sale and distribution of the product in question. Similarly, the registration of a trade mark implies the exclusive right to use it in commerce. In a sense, therefore, the application of industrial property legislation always involves the creation, strengthening or conservation of a dominant position in the market in which the rights are granted.

149. The dominant positions conferred by the industrial property system may give rise to abuses of economic power with effects similar to those arising from acts of monopolization or other practices which limit competition. In the case of patents and trade marks, however, such abuses derive from the exercise of the rights provided under the law, to such an extent that it may be difficult to determine whether the abuses in question have their origin in the conduct of the holders of the rights or in the industrial property system itself. 158/

155/ Law No. 4506/64, Law No. 4728/65 and various decisions of the Central Bank.

156/ The decision of the Government of Chile to return to their former owners certain enterprises which had earlier been taken over or placed under control has been implemented in some sectors, such as electronics and metal manufactures and machinery, subject to the requirement that the enterprises involved undertake to submit, by a specified date, a scheme for the rationalization and specialization of the entire sector, including diversified ownership of the joint-stock companies concerned, and in particular the absence of large groups of common shareholders, the whole scheme being compatible with the development of a capital market and in conformity with the provisions of the law prohibiting any possible control of those companies or agreements between them of a monopoly nature.

157/ Under this system, which was introduced by the General Industrial Law of 1970, workers' communities were established in the industrial sector and subsequently, in the fisheries and mining sectors.

158/ See OECD, Market Power and the Law, Paris, 1970, p. 178. In fact, the only legislation which seems directly to control the use of patents and trade marks through regulations governing competition is that of the United States of America.

150. Market power linked with the exercise of industrial property privileges thus depends to a large extent on the scope of the rights afforded under the patent and trade mark system. With regard to patents, the crucial factors relate to the period of their validity, the extent of the patentee's rights and the exploitation of the patentin question. One of the chief aspects of trade marks is the extent of the distribution monopoly granted in respect of products bearing such trade marks. Moreover, in both systems also important is the control of the rights which the respective holders may obtain through licensing contracts.

151. This section of the study is devoted to a brief examination of current trends in Latin American legislation with regard to the aspects just mentioned, in so far as they may constitute a means of preventing or controlling the formation or abuse of positions of dominance. In this connexion, it should be mentioned that the region still has bodies of law over 100 years old, such as that of Argentina (Law No. 111 of 1864) and other fairly old ones such as those of Costa Rica (1896), Bolivia (1916), El Salvador (1913) and Honduras (1919). The most recent substantive reforms were introduced in Brazil (Industrial Property Code of 1971), Colombia (Commercial Code of 1971) and Peru (General Industrial Law of 1970),159/ Recently, however, the legislation of the six Latin American countries members of the Andean Group was replaced by common Regulations which were adopted in June 1974. 160/

152. The anomalies of timing and the delays in the process of legislative change (by comparison with other branches of economic law) can be explained partly by the traditional nature of industrial property law, its neutral and technical aura and the importance of its rules in protecting major private economic interests. However, certain new bodies of law - such as those of Brazil, Colombia and Peru and, in particular, the brand-new régime of the Andean Group - as also certain trends in judicial decisions show a tendency towards some modernization of the patent and trade mark system, especially towards making it an instrument of economic policy.

1. Patents

(a) Duration of patents

153. The duration of patents (and hence the duration of the legal monopoly) varies considerably from country to country. In some countries, the law lays down a standard period: 15 years in Bolivia, Brazil, Guatemala, Mexico, 161/ Paraguay and Uruguay, and 10 years in Peru. Under the laws of other countries, patents may be granted for specific periods, usually depending on the wishes of the applicant or the characteristics of the invention. The duration may be 5, 10 or 15 years in **Argentina**, Chile 162/ and

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159/ The other national laws are those of Chile (1931), Cuba (1936), Dominican Republic (1957), Ecuador (1961 and 1964), Guatemala (1937), Haiti (1922), Mexico (1942), Paraguay (1942), Uruguay (1941) and Venezuela (1955). The legal information on which the following examination is based refers to those bodies of law. Express mention of sources will be made only where other laws and regulations are involved.

160/ Decision No. 85 of the Commission of the Cartagena Agreement.

161/ The period may be reduced to 12 years if the invention is not justifiably worked.

162/ In special cases patents may be granted or renewed for a period of 20 years if the inventor resides in Chile and the privilege is not detrimental to Chilean industries.

El Salvador, 5, 6, 9 or 12 years in Ecuador, 10, 15 or 20 years in Honduras; 5, or 10 years in Nicaragua and Venezuela, and an initial period of 8 years with the possibility of requesting an extension for a further 4 years if the invention is being worked, in Colombia. Lastly, in the Regulations of the Andean Group, the maximum period is 10 years from the date of concession, although the patent is initially granted for 5 years and, in order to secure an extension, the patent must be shown to have been adequately worked.

154. Within this range of legal time-limits, the most recent laws reveal a marked tendency to limit the duration of patents either generally, as in Peru, or depending on the working of the protected inventions (Colombia, the Andean Group and, to some extent, Mexico). On the other hand, the admissibility of different durations in each country, although provided for in many laws as being in the applicant's interest, may offer the authorities a suitable instrument for regulating the duration of privileges, according to the nature of the privileges or the activities to which they apply.

(b) Rights of the patentee

155. In considering the significance of patentee rights as factors contributing to a dominant position, at least the following aspects should be taken into account: the existence of non-patentable items, the inclusion of requirements of public interest among the criteria of patentability and the extent of import barriers conferred by patents.

(i) Non-patentable matter

156. Besides those inventions which are not patentable because they do not fulfil certain basic conditions (novelty, truly inventive activity, industrial application), there are certain matters which are unpatentable for reasons of public order - for instance, the desire to protect the consumer and to prevent the creation of private monopolies in certain types of activities of social interest. In Latin America, several countries prohibit or restrict the patentability of pharmaceutical products, foodstuffs and chemicals, and of the processes for obtaining them. Medicaments and pharmaceutical products are not patentable in Argentina, Bolivia, Chile, Colombia, Mexico, Paraguay, Peru, Uruguay or Venezuela. The processes for such products are not patentable in Brazil. Foodstuffs cannot be patented in Brazil, Chile, Colombia or Venezuela. 163/

157. Lastly, it should be noted that Decision No. 24 of the Andean Group empowered the Commission of the Cartagena Agreement to specify the productive processes, products and product groups in respect of which no patent privileges might be granted in any member country and to decide on the treatment of any privileges already granted (art.26). The Industrial Property Regulations of the Andean Group later stipulated that no patent could be granted in respect of pharmaceutical products, medicaments, therapeutically active substances or beverages or foodstuffs of animal or vegetable origin intended for human consumption (art. 5 (c)). Moreover, by introducing the principle of selectivity already contained in the Peruvian legislation, 164/ the regulations prohibit the

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163/ Chemical substances may, however, be patented in Argentina, Bolivia, Costa Rica, Cuba, the Dominican Republic, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru and Uruguay.

164/ The Regulations giving effect to the Industrial Law of Peru provide that patents shall be protected provided they contribute to permanent and self-sustaining industrial development and are of social interest.

patenting of inventions affecting the development of the member country concerned (art. 5 (e)). The same principle is reflected in the rule providing for the conditional granting of patents in respect of inventions of interest to national security and to processes, products or product groups reserved by the government or to which special provisions of the law apply.

(ii) Coverage of rights conferred by patents

158. The general rule traditonally applied in Latin America is to confer on patent owners exclusive rights of which the scope extends to the manufacture of the product, its importation, use, sale and/or marketing, as well as the use and sale of the processes for applying the patented invention. Recent government action, however, has begun to restrict the absolute and universal character of patentees' rights.

159. In Peru, no patent owner may refuse to sell a patented product or a licence in respect of that product to anybody seeking it for industrial purposes. Under the law, any refusal to sell or the fixing of an unjustifiably high price causes the patent to be revoked.

160. In Argentina, the Supreme Court of Justice ruled, during the hearing of a case involving the breach of a patent covering a unique process for the manufacture of a medicinal product, that the monopoly of the substances concerned could not be recognized through the legal protection of a unique process. At the same time, the Court ruled that the Argentine legal régime did not prohibit the import of pharmaceuticals manufactured abroad or of components of pharmaceutical compounds manufactured in Argentina, even if they came from other countries whose laws allowed some exclusivity with regard to the product or to the process by which it was obtained. In this connexion, the Court considered that it would be absurd to allow the monopoly indirectly to reconstitute itself by prohibiting the entry into the country of those products or their component substances obtained by the only process patented. 165/

161. In the Industrial Property Regulations of the Andean Group, a patent does not confer an exclusive right with respect to the import of the patented products or to manufacture of products under patented processes (art. 28).

(c) Working of patents

162. Among the so-called abuses of the rights of a patent owner/holder, failure to work the patent is the one which has aroused most concern and given rise to the greatest amount of legal action. In such cases, it is clear that possession of the legal monopoly openly distorts the social objectives it is designed to promote. Consequently, it is not surprising that the laws in force in Latin America, as in other countries and in accordance with the current principles of international law, should have established from the outset various ways of dealing with that restrictive practice. However, it may be useful to mention the existence of a few legislative innovations and advances resulting from recent action taken on the subject by several countries of the region.

163. The owner's obligation to work the patent is expressly stipulated in all the legislation in Latin American countries, except in Chile, El Salvador, Haiti and Paraguay.

165/ The Supreme Court of Justice of Argentina, 21 December 1970, American Cynamid v. Unifa, S.A.

Few laws have defined the concept of patent working, and this has given rise to disparate interpretations ranging from utilization of the patent by any means, to meeting the demand of the internal market.[166] The latter is precisely the criterion applied in the Brazilian legislation. The regulations of the Andean Group also include a clear definition of the concept of exploitation, which refers to continuous and established use of the patented processes or the manufacture of the product covered by the patent in reasonable marketing conditions, provided such use or manufacture occur in the territory of the member country which granted the patent (art. 31).[167]

164. Failure to work a patent is penalized in various ways in almost every country of the region. The system of *compulsory licensing* has been established as the chief method in the laws of Brazil, Colombia, Cuba, Mexico, Peru, Uruguay and in the regulations of the Andean Group. The granting of this type of licence is made subject to a number of conditions. With regard to the duration of applications, it is generally required that between three and four years should have elapsed from the date of application for, or granting of, an unworked patent. Except in Peru, Chile and in the Andean Group's regulations, compulsory licensing requires the intervention of the courts.

165. Time limits, procedural limitations and the difficulty of proving non-working,[168] which arise from the lack of clarity in many legal definitions, combined with other technical difficulties connected with the effective transfer of know-how,[169] explain why this measure has so far not proved effective in Latin America. To claim the contrary on grounds that the value of compulsory licensing must be judged by its capacity to encourage the free granting of licences, would be the same as to suggest that the anti-monopoly laws in force in Latin America have served to prevent restrictions on competition.

166. An important measure facilitating the granting of compulsory licences is the provision in the regulations of the Andean Group under which the governments may authorize such licences whenever the patents relate to public health matters or national development needs. This type of "automatic" compulsory licence is also provided for in the Colombian legislation.[170]

167. *Automatic expiry or revocation of patents* are measures used by various countries of the region. Argentina, Bolivia, Costa Rica, Cuba, Ecuador and Venezuela provide for automatic expiry after a given period during which a patent has not been worked. Brazil and Peru permit the revocation of patents by the administrative authority.

168. In several of these legislations, the measures mentioned are applied only as subsidiary penalties which are resorted to only when compulsory licences have not achieved their purpose. However, in Argentina and Venezuela, automatic expiry is

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[166] See UNCTAD, "The Role of the Patent System in the Transfer of Technology to Developing countries", *op cit.*, para. 338.

[167] In order to verify that the patent is actually being worked, the Peruvian system and the Andean Group's regulations (art. 30) require the owner to notify the competent authorities when working commences.

[168] In Brazil, Colombia, Peru and in the Andean Group's regulations, the law provides for the grant of compulsory licences also in cases where the working of the patent does not satisfy the demand for the product. However, no known cases of application of this legal hypothesis have been recorded.

[169] See UNCTAD, *ibid.*, para. 338 *et seq.*

[170] National laws also permit the granting of compulsory licences when they are requested by the owner of a patent whose working requires the use of another patent.

the only measure provided for and is subject only to the requirement that the patent should not have been worked for a period of two years or that its working should have been interrupted for the same length of time. In addition, the Supreme Court of Justice of Argentina has ruled that the two-year period envisaged in the law is a compulsory one, stating that if circumstances such as delays in commissioning expensive machinery, organization problems or advertising campaigns were taken into account, the intention of the law would be frustrated in so far as its purpose was to bring to the community - within a reasonable period - any benefits which might be derived from the working and circulation of the invention. [171]

2. Trade Marks

169. Registration of a trade mark enables its owner to restrict the distribution of a product by reserving to himself, to a dependent enterprise or to an independent distributor exclusive marketing rights in a given territory.

170. The trade mark system recognizes in principle the right of the owner to prevent the import of products bearing the same trade mark, although the coverage of that right in the bodies of law compared here is less than in the case of patents. [172] The only Latin American legislation to have introduced innovative rules on the matter is the Industrial Property Regulations of the Andean Group, which provide that the owner of a trade mark cannot object to the import or entry of goods or products originating in another member country and bearing the same trade mark.

171. Another important provision of the Andean Group regulations, which is linked to the market power conferred by trade marks through their effect on consumer preferences, is the one permitting trade marks to be cancelled when their owners or licenses have speculated on or made improper use of the price or quality of a product covered by the trade mark, to the detriment of the public or of the economy of the member country (art. 77).

3. Licensing contracts

172. Certain abuses on the part of the owner of a patent or trade mark may arise from the inclusion of restrictive clauses in licensing agreements. Such abuses, aimed at extending the exercise of the power conferred by industrial property privileges, may be detrimental to competition and, as such, would normally be subject to the penalties provided for in the laws concerning restrictive business practices.

173. As was mentioned in the preceding chapter, the five anti-monopoly laws in force in Latin America bring under regulation certain categories of horizontal and vertical arrangements - such as price fixing and tie-in and exclusivity clauses - which might in practice arise from patent and trade mark licensing agreements. However, restrictive clauses in licensing agreements have never led to cases requiring enforcement of the relevant law.

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[171] Supreme Court of Argentina, In e Duranti v. Supramar S.A., quoted in B. Aracama Zorraquin, "Carta de Argentina", in Intellectual Property, WIPO, first quarter 1974, p.50.

[172] See UNCTAD, Restrictive Business Practices, op. cit., para. 124-134, and OECD, Market Power and the Law, op. cit., p. 179.

174. Very few industrial property laws control licensing agreements. In Bolivia, 173/ Brazil, 174/ Colombia, 175/ Ecuador, 176/ Peru, 177/ and Venezuela, 178/ licensing contracts must be registered with the industrial property authorities before they can have effect with respect to action against third parties. 179/ Only in Brazil and Peru, however, does State intervention involve an authorization procedure and, consequently, imply the possibility of denying registration of contracts containing such clauses. On the other hand, only in Brazil and Colombia are certain restrictive clauses in licensing contracts prohibited by law. In the case of Brazil, the prohibited clauses relate to restrictions on exports and imports of inputs required for production purposes and the grant-back to the licensor of improvements or innovations of the licensee. In Colombia, the law considers void any clauses which impose commercial or industrial limitations that do not derive from the rights conferred by patents or trade marks, but it does not establish any procedure for government intervention.

175. Thus, only one country's industrial property law provides for direct State control of any abuses which may arise from licensing agreements. As will be seen in detail in chapter IV of the present study, this does not mean that the Latin American countries pay no attention to such restrictive practices. On the contrary, almost all the national systems include fairly elaborate regulations on the subject, although their purpose is not to control restrictive clauses in all licensing contracts - which explains the fact that they are absent from the industrial property laws - but in those relating to the international transfer of foreign technology and trade marks.

F. Conclusions concerning indirect control of market power

176. The foregoing examination of some of the main instruments of State intervention in Latin America does not permit any definite conclusions to be drawn or any general formulas to be developed concerning their actual or potential use in controlling market power. As has been seen, most of these instruments are somewhat ambivalent in their effects on the creation or application of restrictions on competition.

177. It must, however, be recognized that the legal and administrative factors which are the most important in controlling economic power are to be found in the area of general economic policy, especially those aspects of policy which have been analysed in this chapter. Measures for the direct control of market power, i.e. the small number of anti-monopoly laws in force in the region, seem to be little more than adornments by comparison.

178. Some important common features and tendencies in the orientation of such policies and methods of implementing them can nevertheless be discerned in the various countries.

173/ Law of 2 December 1916 (art. 41) and Law of 15 January 1918 (art. 28).

174/ Industrial Property Code, arts. 29 and 90.

175/ Commercial Code, art. 616.

176/ Patents Law of 1961, arts. 40 and 41; Trade Marks Law of 1964, arts. 11 and 12.

177/ P.S. 001-71-1c - PS/71, arts. 51 and 52.

178/ Industrial Property Law, art. 4

179/ In other countries, such as Chile, the registration of licensing contracts may be regarded as mandatory by virtue of the tax regulations.

179. Firstly, the concept of competition as a means of regulating the allocation of resources, encouraging technological progress and controlling production decisions does not appear to play an important role in the economic policies of the countries considered. In many cases, a competitive market appears to conflict with the now increasingly clear objective of maximizing scales of production to take advantage of economies of scale and the small size of production units. Economic power thus tends to be considered in terms of its effectiveness or ineffectiveness in relation to specific industrial development objectives and to be tackled with the same economic policy instruments as are applied in pursuing such objectives.

180. Secondly, despite the liberal principles officially espoused, private enterprise does not occupy a clearly central position in most of the countries of the region, at least in comparison with the basic role it continues to play in other market-economy countries. The State possesses significant economic power and such power can be used as a means of controlling or counterbalancing private economic power.

181. Thirdly, owing to the persistent and worsening imbalances between various sectors of production, Latin America still has appreciable scope for policies designed to promote economic power. On the other hand, policies for the promotion of small and medium-sized firms, and especially measures conducive to the concentration of companies, tend to coincide with measures for the protection and promotion of domestically owned enterprises and may therefore also be regarded in the light of the considerations referred to in part two of this study.

182. Fourthly, the effective acceptance of dominant positions and restrictions on competition as being essential to the efficient functioning of the economic system does not preclude the application of general corrective measures in addition to the instruments of direct and specific State intervention (price controls, controls on access to markets and industrial regulations, penetration by State enterprises). Obvious examples of this type of action are the restrictions on the centralization of economic power which may result from company law, regulations concerning the capital market, labour legislation, etc., on the one hand, and, on the other hand, modification of the provisions of industrial property law - a process which has been initiated by various countries - with the aim of curbing the monopoly effects arising from the use of patents and trade marks in matters such as the duration and scope of the rights granted, and measures to link those rights to continuing economic policy requirements.

PART TWO

CONTROL OF RESTRICTIVE BUSINESS PRACTICES ARISING OUT OF INTERNATIONAL ECONOMIC RELATIONS

183. This part of the study is devoted to an examination of measures for controlling restrictive practices which may arise from relationships between enterprises centred in foreign countries and enterprises established at a local level, whether or not directly dependent on such foreign enterprises, for example, a subsidiary.

184. Attention has already been drawn to the difficulty of making a clear distinction between restrictive practices arising and occurring within national boundaries and restrictive practices originating abroad. Moreover, various Government policies designed chiefly to regulate the factors of production within a domestic economy may also have important regulatory effects on foreign decision-making enterprises. A number of these instruments of State intervention, such as price control, industrial promotion schemes, public enterprises and industrial property systems, have already been examined, but further reference will be made to them in this part of the study to the extent that they play a significant role as complementary or alternative methods to specific instruments for controlling international restrictive practices.

185. The problem of controlling international restrictive practices cannot be approached without first considering how far legislation on the direct control of market power, and more particularly anti-monopoly laws, can serve as a framework for action. The following section of the study analyses two aspects of this question: (a) general control of international restrictive practices through anti-monopoly legislation; and (b) control of restrictive practices affecting competition in regional integration schemes.

Chapter III

CONTROL OF INTERNATIONAL RESTRICTIVE PRACTICES

A. Domestic control through anti-monopoly legislation

186. In theory, there are no legal obstacles to applying the conventional laws on direct control of market power to restrictive practices originating beyond national frontiers, in so far as such practices are deemed to restrict competition in that economy. All the restrictive practices covered in the five existing national anti-monopoly laws in Latin America may be engaged in the context of international economic actions or relationships. Moreover, the acquisition and concentration of enterprises, acts tending to create a monopoly, and horizontal and vertical agreements are all common manifestations of the exercise of international economic power.

187. As has been noted, the legal definitions of the geographical scope of restrictive practices are generally sufficiently broad and, except possibly in the case of Brazil, do not preclude control of acts occurring outside national frontiers. 180/ It is one of the general principles of the anti-monopoly regulations, moreover, that acts occurring abroad may be considered punishable when they produce effects within the country concerned.

188. However, in only two Latin America countries - Argentina and Chile - is express provision made in the law for the possibility of controlling restrictive practices involving a foreign or international element.

189. The Argentine Law refers to both internal and external trade as areas in which monopoly is exercised (art. 1) and to the obstruction of internal or international trade as a means of establishing a monopoly. 181/ The Chilean Law lists among punishable offences acts tending to impede free competition in foreign trade. 182/

190. These provisions may be construed as covering restrictive practices arising from import or export transactions, where these practices may produce effects within the country. 183/ There are, however, no recorded cases of consideration being given to the possibility of applying the laws to such circumstances. In Argentina, a judgement given some considerable time ago would appear to rule out any such possibility. 184/

180/ See chapter I, para. 10.

181/ Law No. 12 906, art. 2(b).

182/ Legislative Decree No. 211 of 1973, art. 1.

183/ External trade did not come within the scope of the law previously in force in Chile (Law No. 13 305 of 1959), which the Anti-Monopolies Commission interpreted as not covering "organizations whose purpose is the grouping together of producers for the sole purpose of exporting their goods on the best possible terms" (Decision of 1 June 1960).

184/ In a judgement given under Law No. 11 210 of 1923 in a case involving the activities of a foreign-owned subsidiary in Argentina, a court ruled that the enterprise concerned "can be tried only for acts committed within the bounds of Argentine jurisdiction, wholly irrespective of the aims which may be pursued by the foreign company of which it is said to be an affiliate" (Criminal Court of Appeals of Buenos Aires, 5 May 1936).

191. On the other hand, the presence of foreign elements in monopoly-type situations is a factor which has been taken into account by both countries - although not on a systematic basis - in deciding upon State intervention. In the statement of basic considerations underlying the Argentine Law it was maintained that "it is no secret to anyone that a large number of forces linked to international trusts or cartels are active in the Argentine Republic; consequently, anti-trust legislation must prohibit acts or operations of internal monopoly and acts or operations which are conceived abroad but which are carried out in Argentine territory". On the basis of this consideration article 8 of the Law empowered the Argentine Government to "propose any measures that may be necessary to safeguard the national economy in so far as it is or may be affected by acts or operations of international monopolies"; but these measures were never laid down within the specific framework of the Anti-Monopoly Law. 185/ It is, however, worth noting how a recent court ruling viewed the dependence on foreign interests of enterprises established in the country as a factor to be taken into account in considering the activities concerned. 186/

192. In Chile, as has already been seen, the Government is empowered by law to authorize practices that restrict competition where they are necessary "for the stability or development of national investment". 187/ This rule - or, to be more precise, a similar provision in the legislation previously in force - has been applied only once, in the case of a merger of domestic enterprises. 188/ As was mentioned earlier, this rule also served - although not directly - as the basis for approval of an agreement on allocation of production quotas involving a domestically owned company and two foreign-owned enterprises. The Anti-Monopolies Commission ruled that, in view of the sizable participation in the agreement of a domestically owned enterprise, the agreement was permissible - *inter alia* because, in the Commission's view it guaranteed the stability of national investment by protecting it against the competition offered by foreign capital. 189/

185/ Proceedings of the Chamber of Deputies, 1946, quoted in Aftalion, *op.cit.*, p.359.

186/ This is the case of the three packing plants already referred to (see para. 8 above) in which the court decided to reject the excuse tendered by the two foreign enterprises in justification of their policy of refraining from buying cattle in order to drive down the price. In rejecting the defendants' claim that they had been seeking to co-operate with the Government in its fight against inflation, the court considered it pertinent to ask "what, in the case of such enterprises, would normally be the outcome of the conflict between their legitimate self-interest and the good advice furnished by officials responsible for guiding sectoral economic policy in the country in which they are operating as domestic companies, particularly if such domestic character is in practice nullified by the fact of their being subordinate to or quite simply owned by extranational entities" (National Economic Offences Court of Appeal, Division III, 27 June 1973).

187/ Legislative Decree No. 211, art. 4.

188/ Decision of the Anti-Monopolies Commission of 12 March 1962. See para. 23 above.

189/ Decision of the Anti-Monopolies Commission of 9 August 1960. See para. 48 above.

B. Regional Control of Practices Restricting Competition within Economic Integration Schemes

193. Like other regional integration systems, the four groupings in Latin America have adopted special provisions designed mainly to ensure that goods are marketed under conditions of free competition within the geographical areas concerned.

1. Latin American Free Trade Association (LAFTA)

194. Resolution No. 65 of the Conference of the Contracting Parties 190/ contains a general condemnation of "unfair practices of any kind, especially practices which, through the price mechanism, lead to (a) misuse of the margin of preference resulting from the concessions, 191/ to the detriment of the country which granted them; (b) distortion of the normal conditions of competition between entrepreneurs in the region"(art.4). The LAFTA system provides that any Government affected by restrictive practices (the expression normally used is "dumping and other unfair practices") may refer the matter for action to the Association's Standing Executive Committee, which must investigate the practices and inform the Governments of the measures which it considers to be necessary. The Committee may request the Governments of the countries in which the restrictive practices originate to take the necessary steps to prevent them; authorize the Governments of the countries affected to impose import restrictions, etc. Restrictive practices are defined according to a number of general criteria, including "the existence of monopoly, cartelization of supply inadequate to meet demand ... which bring about abnormal changes in prices; the price terms offered by the producers with the highest productivity in the area; and real damage which is caused or threatens to be caused to any established or developing production sector of a Contracting Party" (art. 6). So far, the LAFTA bodies have not taken action under these provisions.

2. Central American Common Market

195. Article XII of the General Treaty on Central American Economic Integration prohibits any unfair business practices which private enterprises may engage in in marketing their goods in other countries - for instance, the underpricing of exports "in such a way as to harm or to risk harming the production of the other countries or to retard the establishment of a national or Central American industry". 192/ The absence of provisions concerning control of market power led the Central American Economic Co-operation Committee to adopt Resolution No. 115 of 1962, which states that "practices, understandings or agreements between commercial or industrial enterprises which tend to restrict competition or limit trade among Central American countries are contrary to the aims pursued under the Economic Integration Programme".

196. Some eight cases have so far been brought before the Council, almost all involving alleged dumping of manufactures. 193/ Resolution No. 115 also called for the approval of a protocol defining practices constituting restriction of competition and laying down

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190/ 19 November 1962.

191/ This is a reference to the system of tariff reductions established by the Treaty of Montevideo.

192/ Under the established procedure, the State affected must submit the matter for consideration to the Executive Council. The latter has to give a ruling within 60 days.

193/ See INTAL, La solución de conflictos en la integración centroamericana, Serie Estudios No.8, Buenos Aires, 1972, p.53.

penalties and measures applicable to such practices. This protocol has not yet been approved. However, the priority objectives of the current effort to reorganize the Central American Common Market include the adoption of specific provisions on control of the creation of monopolies, market sharing and other practices restricting competition at the regional level. 194/

3. Andean Group

197. Pursuant to the provisions of chapter VIII of the Cartagena Agreement, the Commission of the Andean Group adopted Decision No. 45, introducing "rules to prevent or eliminate practices which may distort competition within the subregion". 195/ The preamble to that Decision recognized that, at the time of its adoption, there was not sufficient experience of circumstances which could be regarded as restrictive practices and that it was necessary to accumulate experience in order to be able to define such practices with precision. Nevertheless, the Andean Group's system, like the other systems described earlier, appears to be directed mainly towards the control of dumping and other practices producing equivalent effects (although the Decision mentions as examples of such practices "undue manipulation of prices" and "machinations calculated to disrupt the normal supply of raw materials"). The bodies established under the Cartagena Agreement have still not assembled the basic elements for a definition of practices which distort competition and have taken no intervention measures of the kind provided for in the regulations. 196/

4. Caribbean Community

198. The Treaty of April 1973 establishing this integration system differs from the other regional integration schemes in that it contains provisions specifically related to control of the emerging market power of enterprises established in the region. Article 30 of the annex to the Treaty declares the following restrictive practices to be incompatible with the trade liberalization programme: "(a) agreements between enterprises, decisions by associations of enterprises and concerted practices between companies which have as their object or result the prevention, restriction or distortion of competition within the Common Market; (b) actions by which one or more enterprise takes unfair advantage of a dominant position within the Common Market or a substantial part of it". The Council of the Community is empowered to make recommendations and take decisions to deal with practices referred to it. Provision is also made for a review to include consideration of the following matters: specification of restrictive business practices or dominant enterprises with which the Council should, be concerned; methods of securing information about such practices or enterprises; procedures for investigation; and whether the right to initiate inquiries should be conferred on the Council. Finally, Member States undertake to introduce within the near future uniform legislation for the control of restrictive practices in their respective territories.

194/ See Permanent Secretariat of the General Treaty on Central American Economic Integration, El desarrollo integrado de Centroamérica en la presente década, op.cit., pp. 93-94.

195/ 9-18 December 1971.

196/ Decision No. 45 lays down a procedure similar to those in force within other integration systems, based on a request to the regional bodies to authorize measures which are then applied by the State affected.

199. Cartelization and the allocation of markets are practices which are known to occur both in the LAFTA area and in the Central American region. These practices are generally the result of informal agreements between a small number of enterprises producing the same article and occupying dominant positions in the countries concerned. The agreements are designed to maintain control by the enterprises concerned over their respective national markets and thereby avoid competition which would otherwise exist in conditions of free trade. These enterprises are often subsidiaries of large foreign firms. Some of them were established before and some after the launching of integration systems, but generally they prefer the advantages derived from schemes for the protection of individual national markets to the benefits arising from the creation of larger domestic markets through economic integration schemes. Moreover, a number of such enterprises have entered into specialization agreements between themselves which permit the interchange of various goods in a particular branch of industry, while nevertheless maintaining reserved national markets in each country. 197/

200. From this brief review of regional machinery for the control of restrictive practices, it may be concluded that countries have approached this problem rather warily. The instruments devised are generally designed to prevent unfair practices - usually based on international trade - such as dumping, rather than to control practices restricting competition which arise from positions of dominance. 198/ The means of action adopted do not at present grant significant powers of intervention to the integration organs - except possibly in the case of the Caribbean Community. It should also be noted that the current re-ordering of priorities in the Latin American integration systems, particularly in the Andean Group, to place greater emphasis on sectoral programming of production in the various member countries would imply in certain cases acceptance of positions of dominance and absence of competition. It is thus possible to reach a conclusion somewhat similar to that in the preceding chapter regarding the need to deal with economic power on the basis of criteria of regional efficiency and through direct intervention by means of industrial policy machinery. 199/

197/ Cartelization within Latin American integration systems is a subject which has not yet been adequately investigated. However, some comments on the question may be found in "El desarrollo integrado de Centroamérica en la presente década", op.cit., p.93, and C. Ianni, La crisis de la ALALC y las corporaciones internacionales, op.cit.

198/ It is also worth noting that the Andean Group, when it adopted Decision No. 45, was putting into effect Decision No. 24, which is the basis for the principal measures taken to control international restrictive practices in the area concerned.

199/ See, for example, Board of the Cartagena Agreement, Bases generales para una estrategia subregional de desarrollo, Lima, 1973, chapter I.

Chapter IV

CONTROL OF FOREIGN INVESTMENT

201. Until very recently, foreign investment in Latin America was treated in accordance with traditional economic theory concerning the relationship between factor movements across national frontiers and the relative factor of wealth of each country. It was therefore dealt with as a matter of capital flows from a uniform international market, which were reflected in the recipient country's accounts, and of incentives, also uniform (partly because they made no distinction between domestic and foreign capital), designed to stimulate and safeguard investments. Incentives were considered essential for attracting capital, just as they are needed, for example, to induce small savers to invest on the stock exchange.

202. In 1967, only three Latin American countries - Argentina, Brazil and Chile - had any basic legislation on foreign investment. Moreover, in two of them - Argentina (Law No. 14,780 of 1958 on capital investment) and Chile (the "Investor's Charter", Decree No. 258 of 1960) - the main object of the legislation was to codify the various benefits and prerogatives attaching to capital invested in the financing of import substitution.

203. A few years later, foreign investment policies as a whole presented a distinctly different picture. By the beginning of the 1970s, the legislations of most of the countries concerned included special foreign investment régimes based on completely different policy instruments. The five founding States of the Andean Group played a pioneering rôle in the creation of this new legislation by adopting a common régime for the treatment of foreign capital in June 1971. This now constitutes the legal framework applicable to foreign investment in Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela. 200/ Special foreign investment régimes were introduced by Argentina in 1971 and again in 1973 201/ by Mexico in 1973 202/ and by Uruguay in 1974. 203/ In Brazil, a system of legislation established over 10 years ago 204/ is still in force but has been brought up to date in various respects through regulations and policies introduced in recent years. Furthermore, the countries of the Central American and Caribbean Common Markets are at present preparing foreign investment measures on the basis of the reorganization of the regional integration systems in force in the two areas. 205/

200/ Of these countries, only Chile (Decree No. 258 of 1960) and Colombia (Decree No. 444 of 1968 and the supplementary legislation issued under that Decree) previously had any legislation on foreign investment.

201/ In December 1973 Law No. 19,151 of 1971 was replaced by Law No. 20,557 and the regulations issued pursuant to that law in Decree No. 413 of February 1974.

202/ Law of 16 February 1973 for the promotion of Mexican investment and the regulation of foreign investment; this replaced and to some extent codified a whole series of separate legislative instruments and policies going back to a decree of 1944.

203/ Law No. 14,179 of 10 April 1974.

204/ Laws Nos. 4,131 of 1962 and 4,390 of 1964 and Decree No. 55,762 of 1965.

205/ See article 44 of the Annex to the Treaty Establishing the Caribbean Community, 1973, which provides for the adoption as far as possible of a common policy on foreign investment.

204. The reasons for this change are many and diverse: both internal circumstances in the Latin American countries - social and political changes, new development goals and changes in industrialization strategy - and international phenomena, in particular changes in the distribution of power in the world economy and in co-operation links between the countries of Latin America. 206/ In any event, it is striking that the new foreign investment policies were put into effect simultaneously by the various countries and that the goals pursued and the policy instruments selected have much in common, despite the fact that significant differences persist in other areas of national economic policy. This is probably due to the fact that the factors underlying the foreign investment process and its various effects have tended to be of a similar nature and to occur at the same time in all the countries of the region. This process may be regarded as the logical outcome of a clash between two forces which had previously co-existed in apparent harmony. On the one hand, States began to enter previously untouched and unregulated fields of activity, which from the legal standpoint they categorized as areas of "public policy" and "national interest"; on the other, foreign capital rapidly penetrated and expanded throughout national economies, especially in certain activities and through the use of methods which specifically affected the new priorities and targets of State intervention. Government interest in the problem of foreign investment centred mainly on the question of the domination of particular economic sectors and on certain means of access by foreign enterprises to the various countries and some aspects of their activities within them, particularly the "denationalization" of economies through the purchase of domestically owned enterprises and their displacement from the domestic market for goods and factors of production through the exercise of the foreign enterprises' technological and financial superiority.

205. The re-shaping of national policies is also based on other considerations - still largely uninvestigated in any systematic way - such as the contribution of foreign investment to the balance of payments, its effects on employment and the relationship between foreign production methods and existing local resources. 207/

206. However, the decisive element in the policy shift was probably the fact that foreign investment came to be regarded as a power phenomenon when it was realized that much of it was controlled and directed by decision-making centres situated abroad and set up as international entities for the systematic and co-ordinated conduct of business through a network of production units located in various countries. Consequently, because of the participation of these large enterprises in the basic variables of the economic system - the structure and volume of imports, the kind and amount of production, the direction of exports, tax collection, and internal and

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206/ For background studies of the causes of the change in attitude towards foreign investment in Latin America see, inter alia, C. Vaitsos, "El cambio de políticas de los gobiernos latinoamericanos con relación al desarrollo económico y la inversión extranjera directa", in El Trimestre Económico (Mexico), January 1974, and M. Wionczek, Inversiones y technología extranjera en América Latina (Mexico, 1971).

207/ For a general review of these matters and reference to various studies on the subject, see Multinational Corporations in World Development (United Nations publication, Sales No. E.73.II.A.11) and "The impact of multinational corporations on the development process and on international relations: report of the Group of Eminent Persons to Study the Role of Multinational Corporations on Development and on International Relations" (Economic and Social Council document E/5500/Add.1).

external financing - it was impossible for those variables to be regarded any longer as independent and objective factors subject to the control of national economic policy, since they also represented prime factors in the over-all international planning of the activities undertaken by these enterprises in the recipient countries. Hence the problem of micro-economic domination, a question centring on the volume and structure of foreign investment in the economy, began to be seen as wider matter involving governmental decisions on the control and effects of general development tools.

207. For the purposes of the present study, there are two aspects of policy with regard to foreign investment which deserve to be specially mentioned. Both are to be found in one form or another in most of the new national systems and both represent new departures from traditional ways of approaching the problem:

- the idea that foreign investment is a bilateral relationship between a foreign enterprise and a Government in which both parties are interested in securing maximum benefits at minimum cost from a joint undertaking, through a negotiating process whose results depend on the relative bargaining power of the two parties and the clarity of their respective aims. As a consequence, the question of investment by external entities is viewed as a matter of public order which cannot be left to private initiative.

- the characterization of the foreign concern as an entity which, by reason of its structure and behaviour, has over the course of time shown itself to be fundamentally different from a domestically-owned enterprise and therefore necessarily distinct from it as regards legal treatment. This means the abandonment of the classic principle of "national treatment" for foreigners based on the notion of equality.

208. Whether the foreign investment process is regarded as a confrontation between bargaining powers or foreign enterprises are viewed as economic decision-making centres not normally comparable to domestically-owned enterprises, the objective, as will be seen in what follows, is clearly to control the elements of that process which may exert a certain dominating influence on national economies and the transactions involved.

209. This chapter will deal with four points which may be regarded as constituting four areas of control of market power and restrictive practices linked to foreign investments and enterprises: (a) supervision of the entry and operations of foreign investment; (b) supervision of the acquisition of domestically-owned enterprises; (c) supervision of the organizational structures of foreign investment; and (d) supervision of access by foreign enterprises to local product and factor markets.

A. Control of the entry and operations of foreign investment

210. The régimes applied in Argentine, Mexico, Brazil and Uruguay, and in the countries of the Andean Group which are implementing Decision No. 24 of the Commission of the Cartagena Agreement, include special systems for controlling foreign investment. The chief purpose of these systems is to provide a set of working rules, for negotiations with investors stipulating maximum and minimum requirements as regards the structure and functioning of foreign enterprises. The main features of the systems are as follows:

1. Prior authorization of foreign investment

211. The aim of this requirement is to prevent the automatic and indiscriminate admission of foreign capital. The scope and functions of the authorization system vary from country to country.

212. In Argentina and in the countries applying the Andean common régime, authorization is strictly compulsory for all direct foreign investment. In both the former and the latter, foreign investors must submit an application to the appropriate authority, which is empowered to approve or reject it. Authorization is necessary for all kinds of investment, regardless of kind, amount or sector. Non-compliance with the requirement of prior authorization automatically entails loss of the "natural rights" attaching to the investment, and in particular the right to repatriate the capital and to transfer profits abroad. Reinvestment of profits also requires authorization under both of these legal systems, one of the purposes of which is to control the total amount of foreign investment in the country concerned. 208/

213. A significant aspect of the authorization systems of Argentina and the Andean Group countries is the use of a contractual procedure. The instrument authorizing the foreign investment is a formal agreement, establishing a set of rights and duties, between the State and the foreign investors. The use of agreements of this kind clearly reflects the idea that foreign investment is a matter for negotiation. 209/

214. In Brazil, prior authorization is indirectly compulsory, since the system of registration (the law does not mention "approval") virtually fulfils that role by making it necessary for a foreign capital registration certificate to be produced before foreign exchange can be remitted abroad in connexion with any investment.

215. In Mexico and Uruguay, the principle is that prior authorization is compulsory in certain cases. Under the Mexican system, authorization is required only in the case of investment projects which do not fall within the general terms of the law as

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208/ In the Andean Group, authorization is compulsory where the amount to be reinvested exceeds the capital of the enterprise by more than 5 per cent. For details, see Decision No. 24, articles 12 and 13, and Decision No. 70, of the Commission of the Cartagena Agreement.

209/ In Argentina, investment agreements are signed by the enterprise receiving the foreign capital and by the supervisory authority, but they also involve the "joint and several liability of the foreign investor" (arts. 4 and 31). In the Andean Group countries, "the agreement stipulating the terms of the authorization" (art. 5) is basically designed to set out conditions for the gradual transformation of foreign enterprises into mixed enterprises, a question which will be discussed later. The contractual procedure has also been used in Chile, where the Investor's Statute provides that the agreement shall rank as a public instrument which automatically incorporates the benefits, franchises and exemptions granted to the foreign firm (Legislative Decree No. 258, art. 25), and in Peru, where the Industrial Law provides that any enterprise constituted with a majority of foreign capital shall conclude an agreement with the State (Legislative Decree No. 18,350, art. 16).

regards their capital structure, i.e. where more than 49 per cent of the prospective capital of the recipient enterprise is foreign or where it is proposed to acquire shares held by domestic investors. Registration, however, is compulsory for all foreign investors (article 23). 210/

216. The Uruguayan law calls for "express authorization, with the grounds of the authorization stated" in the case of foreign investment in electric power, hydrocarbons, basic petrochemicals, nuclear energy, the development of strategic minerals, agriculture and livestock farming, the meat-packing industry, finance broking, railways, telecommunications, radio, the Press, television and activities in which State enterprises participate (article 3).

2. Selection in admitting foreign investment and assessment of its costs and benefits

217. Certain criteria for the selection of investment are established in the form of substantive rules governing the structure of ownership, the manner of its admittance and the definition of the sectors within which it may be permitted. We shall deal with these criteria later. As regards the various types of direct investment, the most noteworthy régimes, such as those of Argentina and the Andean Group countries, place a ban on the capitalization of technological inputs and provide for control of the value of goods and equipment imported as investment. These rules are closely related to the control of certain restrictive practices which may arise from the activities of multinational enterprises and will therefore be dealt with in chapter VI.

218. In several régimes general criteria are laid down which must be taken into account by the competent authorities in assessing the costs and benefits of projected investments and in deciding whether or not to approve them. Some of these criteria include considerations connected with the foreign enterprise's control of market power. In Argentina, the law refers to such factors as the restrictions or conditions which may be imposed on enterprises with regard to their export capacity, the possibility that national enterprises may be displaced from the market and the volume of domestic savings that may be absorbed (art. 6). In Mexico the criteria include the structure of the market in which the enterprise is to carry on its business - it must not displace domestic enterprises which are operating satisfactorily nor create any monopoly - and the price and quality levels of the goods to be produced (art. 13). Lastly, Decision No. 24 of the Andean Group specifies that "member countries shall not permit direct foreign investment in activities which they consider to be satisfactorily performed by existing enterprises" (art. 3). 211/

210/ Since there is no exchange control in Mexico, failure to register gives rise to administrative penalties and entails the general invalidity of the acts of the unregistered enterprise (article 28).

211/ In order to ensure that the foreign investment will not be prejudicial to existing industry the Argentine and Chilean systems have established procedures enabling enterprises producing similar or competitive goods to raise objections, public notice must be given of proposed foreign investments and domestic enterprises may, within a specified period, request denial of approval to the investment project. See Argentina, Decree No. 413/73, art. 43 et seq; Chile, Decree No. 258/60, art. 23.

3. Registration and supervision of the activities of foreign enterprises

219. The purpose of the registration system is, firstly, to identify foreign investors and enterprises which are recipients of foreign capital 212/ and in some countries, to control the repatriation of capital and dividends. 213/ Thirdly, the registration system enables governments to exercise permanent control over the activities of foreign enterprises. 214/ It should be noted that, in order to ensure control and supervision of foreign enterprises, the laws of Argentina, Mexico and the Andean Group make it mandatory that shares held by foreign investors be registered. 215/

212/ The system of registration of foreign investments is particularly elaborate in Mexico; foreign individuals or enterprises acquiring shares in domestic corporations or obtaining in any manner control of a local enterprise, or establishing new enterprises; Mexican corporations, a part of whose capital is owned by foreign investors or in the management of which foreigners may hold decision-making power; trusts in which foreigners participate, shares of foreign investors, and shares carrying a guarantee in favour of a foreign investor must all be registered on special forms. See the Regulations of the National Registry of Foreign Investments of 28 January 1973, art. 3 et seq. In Argentina there is also a special section of the Registry where agents or local representatives of foreign enterprises must register personally (Law No. 20,575 of 1973, art. 2).

213/ The purpose of this aspect of registration is to establish the value of the economic input constituted by the investment, or, in other words, to determine the basic capital entitled to repatriation and remittance of profits abroad. This registration function is especially important in systems which impose restrictions in terms of time or percentage on remittances abroad, as in the case of Argentina (Law No. 20,557, arts. 12 and 13), the Andean Common Régime (arts. 7 and 37) and, potentially, Brazil (Law No. 4,131, arts. 28 and 43).

214/ In Argentina enterprises must report every six months on movements of their funds, the amounts authorized for capitalization, the value of the assets invested, the amount of net profits earned, etc. The implementing authority is vested with broad powers to verify and inspect the books of foreign enterprises, their plant and the manner in which they carry on their business (Decree No. 413/73, arts. 40 and 74). In Brazil the registration system also covers all financial flows connected with investments, reinvestments and remittances of profits abroad (Law No. 4,131, art. 30) and empowers the Government to require that enterprises furnish all necessary information (Decree No. 55,762, art. 62). In the case of the Andean Group, Decision No. 24 specifies that registration entails permanent supervision of the performance of the obligations assumed by foreign investors (art. 6), and its functions include centralizing statistical and book-keeping information in connexion with foreign investment and the prices of intermediate products furnished by the investors and recording transfers abroad of sums whose remittance is permitted (art. 6). See, with reference to the countries of the Andean Group, the governmental powers of exercising control and obtaining information provided for in Venezuela, Decree No. 62/1974, especially article 9, paragraphs 10 and 44.

215/ Under Decision No. 24 of the Andean Group the compulsory registration of shares applies in the case of all joint stock companies (art. 45).

B. Supervision of the acquisition of domestic enterprises

220. The purchase of the whole or part of the ownership of domestic enterprises by foreign investors has probably been one of the most important of the factors which set off a chain reaction in Latin American legislation. The available statistics, which were mentioned in the introduction to this study, would not, however, be sufficient to account entirely for the importance attached to this factor by the Governments concerned. Indeed, there are other aspects of the process of becoming more foreign and less national, such as the growth rate of foreign industry and the level of use of domestic productive resources, which may well be both quantitatively and qualitatively more important and which are not necessarily connected with the acquisition of domestic enterprises.

221. It has already been shown that there has been relatively less resort to this form of penetration by foreign investment in Latin America than in other regions, even including more highly industrialized countries, as compared with the establishment of new enterprises, and that in some countries of Latin America it has not been very significant. Moreover, the acquisition of domestic enterprises has, with a few exceptions, tended to concentrate in sectors other than those of basic industry, in which governments have shown the greatest concern for national control.

222. The reaction of the governments would therefore seem better accounted for by other reasons, especially their view of the phenomenon as a manifestation of improper use by foreign firms of their financial, technological and managerial superiority to the detriment of domestic enterprises. This practice is viewed as improper not solely in terms of its consequences for the market - the disappearance of domestic firms - but also because in practice it entails a distortion of a positive aspect of foreign investment namely expansion of the national productive capacity. 216/

223. Direct supervision of the purchase of domestic enterprises is expressly provided for in the laws enacted in Argentina, Mexico and the countries of the Andean Group. There are no formal rules on the subject in the other Latin American countries, so that it may be considered that, in principle, shares held by domestic investors may be freely transferred to foreign investors. It should be pointed out, however, that in Brazil the Central Bank does not in principle accept the registration of foreign capital intended for the purchase of shares on the stock exchange, since it is held that this kind of transaction does not mean "direct investment in economic activity" within the meaning of the requirement in article 1 of Law No. 4,131. 217/ Under the

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216/ Although in many cases the transfer of national firms to foreign ownership may give production units a new lease of technological or financial life, the process does not in itself necessarily add new productive resources to the economy and in some cases it can in fact ultimately lead to a net reduction in productive capacity, depending on the origin of the funds with which the purchased enterprises are paid for, the method of payment and what the owners of national enterprises who are selling do with the proceeds.

217/ The Administration of the Central Bank's Inspectorate and Registry of Foreign Capital (FIRCE) also requires that all transfers of capital by domestic investors to foreign investors be registered (see Application for Registration of Investment, Instructions, item 10).

rules governing the operations of Brazil's Industrial Development Board (CDI), domestic enterprises receiving incentives may not change their ownership structure without prior authorization from the Board. 218/ A similar system is applied in El Salvador, where the Industrial Development Law requires a majority of the capital of enterprises receiving incentives to be owned by nationals, 219/ so that any transfer to foreign investors is, in principle, subject to prior authorization.

224. These systems of direct supervision of purchases differ in some important respects. Although in every case the supervision is of a "structural" type, i.e. is designed to prevent the acquisition of domestic enterprises as such, in Argentina and under the Andean Common Régime the general rule is absolute prohibition by law, whereas in Mexico approval or refusal depends in each case on whether the competent authority considers the purchase to be in the national interest (art. 8 *in fine*). The Mexican system is broader, moreover, as regards the forms of acquisition of enterprises that are subject to control.

225. In Argentina, the law specifies that no permission shall be given for new investments in shares or other holdings in companies or in movable assets where these are connected with the production or marketing of goods existing in Argentina and belonging to Argentine enterprises. It is specified that the prohibition relates to shares or capital holdings owned by Argentine investors and to movable or fixed assets of enterprises the majority of whose capital is owned by nationals (Decree No. 413, art. 6).

226. The Argentine prohibition therefore relates to acquisitions of every kind, regardless of their amount or method, including the purchase of movable assets, i.e. the acquisition of the assets of a local enterprise whose shares are still held by domestic investors. 220/ Nevertheless, the law implicitly excludes the purchase of new shares, i.e. shares issued because of an increase in the capital of the recipient company, provided that the majority of the shares continue to be held by nationals. A basic distinction is thus established between two kinds of acquisition, depending on whether the foreign participation does or does not lead to a transfer of capital resources of the local enterprise. Only one exception to the general prohibition is provided for. This is the case where acquisition of financial or movable assets takes place upon the winding up of a domestic enterprise on bankruptcy and in circumstances which ensure equal opportunity for the acquisition of the assets by Argentine investors. The object of this provision is to take into account the

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218/ CDI circular No. 36, 13 April 1973.

219/ Industrial Development Law, art. 26.

220/ On the use of this method of acquiring domestic enterprises in Argentina, see H. Sauret, *op.cit*. A frequent result of this kind of operation is the subsequent winding-up of the company which sells the movable assets owing to the material impossibility of achieving the company's purpose, that is to say, on a ground admissible under mercantile law.

possibility that sale to foreigners may be the last possibility of survival open to a domestic manufacturing enterprise, and to ensure strict control of such transactions. 221/

227. Decision No. 24 of the Andean Group does not allow direct foreign investment for the purpose of acquiring shares, capital holdings or ownership from domestic investors, except where it is for the purpose of preventing the bankruptcy of a domestic enterprise in a case where, according to reliable evidence supplied by the competent authority, bankruptcy of the enterprise is imminent. Any enterprise in this situation must give domestic investors a preferential right of purchase and the foreign investor must undertake that the shares or interests which he acquires will be offered for sale to domestic investors within a period of not more than fifteen years (art. 3). The prohibition under the Andean system, although basically similar to the Argentine provision, which was based on it, is somewhat more flexible since it does not refer to acquisition of assets nor does it specify that bankruptcy proceedings must be initiated before foreigners may be authorized to acquire shares.

228. The Law of Mexico requires prior Government authorization in cases where foreign investors in Mexican enterprises acquire by one or more acts or by a succession of acts more than 25 per cent of the capital or more than 49 per cent of the fixed assets of an enterprise (art. 8). Authorization is also required for the leasing of an enterprise or of the assets essential for carrying on its business and for acts whereby the management of an enterprise or the power of decision with regard to conduct of the business of an enterprise falls into the hands of foreign investors. The law also establishes the preferential right of Mexican investors to make such acquisitions where the authorities consider this to be desirable.

229. The Mexican system differs in a number of important respects from the Argentine system and the one established under Decision No. 24. In the first place, acquisitions of national enterprises in Mexico are not prohibited, but require authorization from a competent authority, which is to establish whether or not an acquisition is in the national interest. Secondly, acquisitions are subject to authorization, where they involve a transfer of a certain minimum percentage of the shares or assets, and where internal or capital control, external or contractual control, and even de facto control, passes into foreign hands. 222/ These criteria are broader than those used in the laws of Argentina and of the Andean Group. Thirdly, the law makes no distinction between the purchase of shares issued and fully paid up and the purchase of shares by an increase in the capital of an enterprise. Fourthly, the law specifies that the acquisition of shares in domestic enterprises by other enterprises domiciled in the country and of which the majority of the capital is

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221/ An original feature of the Argentine Law is the faculty it grants the Executive Board of the Government "to reconvert, within a period of three years, into Argentine enterprises former Argentine enterprises transferred to foreign investors through the acquisition of shares, capital holdings or assets" (art. 33). Although the Government has not yet made use of these powers, the National Congress approved in 1973 the expropriation of seven banks which had passed into foreign hands since 1966.

222/ The broad scope of the Mexican rule may be regarded as due in some measure to the experience gained over many years of attempts to "Mexicanize" foreign enterprises and, conversely, as an official acknowledgment of the countless devices employed by such enterprises to obtain or maintain control of an enterprise by passing over or under the legal rules. On this point, see H.K. Wright, Foreign enterprise in Mexico: Law and Policies, Chapel Hill, 1971.

owned by foreigners, is likewise subject to control. Concerning this latter situation, no express provisions exist in the law of Argentina or in Decision No. 24, except where the investments made are in national currency, from profits legally authorized to be remitted abroad. 223/ This would not seem to cover other possible ways in which domestic enterprises may be acquired by foreign enterprises.

C. Control of the organizational structures of foreign investment

230. Another important aspect of the "denationalization" phenomenon referred to in the introduction to this study is the problem of foreign domination of certain sectors of the national economy. The Latin American countries have begun to tackle this problem through such means as measures designed to secure internal control of the decision-making structure of foreign subsidiaries.

231. Nearly all the countries of the region have in recent years begun to apply laws and policies which lay down certain model organizational structures for enterprises in which foreign funds are invested. Some of the legal provisions adopted involve some degree of modification of the ordinary rules governing the establishment and functioning of companies. For example, the previously mentioned requirement that shares be registered, and the prohibition of capitalization of inputs of technology, where these involve foreign investment, generally constitute a modification of commercial codes that do not provide for such restrictions on the types of shares or corporate inputs. 224/ The essential feature of these models, however, is not so much the legal form of the enterprise as the financial structure and the system of management of the foreign capital's decision-making centre.

1. The definition of nationality

232. The basic purpose of defining nationality seems to be to legalize the principle of differentiation as between the treatment accorded to enterprises where one of them has foreign connexions. The methods employed to define the "economic nationality" of enterprises are based on the application of the so-called theory of control, which attempts to identify by means of a set of empirical indicators "the preponderant influence in the general conduct of business" and the location of the decision-making centre of the enterprise. 225/

223/ Argentine Law, art. 1.3; Decision No. 24, art. 1.

224/ Other cases of alteration of the normal rules of company law are the requirement (Argentina, Chile and Ecuador) that, where a foreign company desires to participate in the establishment of a domestic company, it must first be registered, or establish an agency or obtain a special authorization from the competent ministry; and the requirement (Colombia) of proof that the assets constituting the foreign investment in a domestic joint stock company have in fact become part of the latter's assets.

225/ See C. Champaud, Le pouvoir de concentration de la société par actions, Paris, 1962, and C. De Visscher, "La protection diplomatique des personnes morales", The Hague Academy of International Law, Recueil des Cours, 1966, p. 427, et seq.

233. In the case of Latin America, the definition of nationality usually applied is based on a combination of factual economic criteria intended to establish the degree of autonomy of the firm's decision-making system vis-à-vis decision-making centres situated abroad. The laws thus generally refer to a typology of enterprises classified according to "degree of nationality". But apart from terminological differences and the explicit or implicit character of the categories employed, the most common classification distinguishes between domestic, mixed and foreign firms. It is in Argentina, Mexico and the countries of the Andean Group that the system of differentiation of firms by nationality is most developed.

234. In Argentina, "foreign enterprises" are those in which the Argentine capital is less than 51 per cent of the voting capital; "mixed enterprises" are those in which the Argentine capital, whether private or government is between 51 and 80 per cent of the total capital and carries power of decision and which is shown to be effectively managed technically, administratively, financially and commercially by the Argentine investors; and "Argentine enterprises" are those in which Argentine investors possess more than 80 per cent of the capital and the same requirements as to effective management as above are fulfilled. 226/

235. In Mexico the basic model of a "Mexicanized" enterprise, as evolved from that country's historical experience and its formal definition in the law on foreign investment, is an enterprise in which the foreign capital participation does not exceed 49 per cent of the total and has no possibility of controlling the management of the enterprise. 227/ This category is at the centre of a theoretical scale of nationality comprising other models of enterprise with different proportions of foreign participation in the total capital: in some cases, the Mexican component must be as much as 60 per cent; in others, the requirement is for domestic companies with statutory exclusion of aliens, 228/ and, in some cases, certain limits are also imposed on the extent of the firm's external ties through contractual relationships. 229/

236. In the Andean Group, the classification is virtually the same as that adopted in Argentina, 230/ although the Common Régime also considers enterprises to be mixed if at least 30 per cent of this capital is owned by the State, or by semi-State entities or State enterprises.

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226 Law No. 20,557, article 2.

227/ Law on Foreign investment, art. 5.

228/ Regulations issued pursuant to the Organic Law enacted under article 27, Section I, of the Constitution, art. 8.

229/ See, in particular, the Decrees of 1971 and 1972 on Industrial Decentralization and Regional Development.

230/ Domestic enterprises are those in which over 80 per cent of the capital is domestic, but this proportion must be reflected in the technical, administrative, financial and commercial management of the enterprise; mixed enterprises are those in which the proportion of domestic capital is between 51 and 80 per cent, subject to the same management requirements, and foreign enterprises are those in which less than 51 per cent of the capital is domestic, or a higher figure if participation in the capital is not reflected in the management.

237. In other countries, the classification systems are less elaborate. In Brazil and Uruguay, for example, the principal current distinction relates to whether the majority of the capital carrying voting rights, 231/ and legal decision-making power 232/ is held by domestic or foreign investors.

238. In the concept of nationality as applied to enterprises by the laws of the various Latin American countries there are in any event, certain important common denominators. In the first place, there is the emphasis on the capital structure as an indicator of the firm's internal control; secondly, there is the recognition of the difference between ownership and control, the requirement being laid down that the domestic capital majority should have effective decision-making power in the enterprise 233/ and, lastly, there is the importance attached to the mixed enterprise, i.e. the enterprise which has both domestic and foreign capital.

2. Mixed enterprises as a form of control

239. This last point deserves to be analysed in greater detail in view of the importance which the joint venture or joint enterprise system as a form of foreign investment has assumed in recent years. For the purposes of this study, there is no need to discuss the economic advantages or disadvantages of this type of organizational structure, a subject on which important studies already exist. 234/ It is, however, important to determine the function which the mixed enterprise system performs or may perform in Latin America as a means of controlling the restrictive practices which may result from foreign investment. The manner in which the use of this type of enterprise has been planned and the special requirements which it has to fulfil imply a new approach compared with previous forms of association between domestic and foreign capital. The history of foreign investment in Latin America includes many cases of joint ventures established either through government pressure or on the initiative of the foreign enterprises themselves, because they were interested in acquiring local partners and thus obtaining direct knowledge of the local market or better public relations with the government. 235/ In many of these

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231/ One of the principal legal provisions in Brazil is article 39 of Law No. 4,131.

232/ Uruguay, Law No. 14,179, article 10.

233/ The distinction is based on recognition of the existence of other methods of controlling enterprises, methods which do not require participation in the ownership of the enterprise controlled but derive from the use of functional dependence relationships that may be established through contractual arrangements such as those connected with the transfer of technology, external financing and marketing.

234/ See, inter alia, J. Tomlinson, the Joint Venture Process in International Business, Cambridge 1970; E. Stopfard and L. Wells, "Managing the multinational enterprise", New York, 1970; L. Franko, "Joint ventures survival in multinational Corporations", New York, 1971.

235/ See the history of some important cases in V. Friedmann and J. Beguin, Joint International Business Ventures in Developing Countries, New York 1971. On the attitude and methods adopted by international firms in cases where they have to accept the organization of their subsidiaries as joint ventures, reference may be made to the publications of Business International Corporation, Organizing for LAFTA operations, 1969, and Recent experiences in establishing joint ventures (Management Monographs No. 54, 1972).

cases, the domestic participation constitutes no more than additional support for the foreign investor in the form of the intangible contributions already mentioned and of capital. Moreover, from the formal point of view, the effects of "domestic participation" have often been achieved through the opening up of the foreign enterprise's capital structure, its shares being traded in the local stock markets. 236/ On the other hand, in the case of equal foreign and domestic participation in the capital of a firm, skilful manipulation of the rules of company law has made it possible for systems of management to be devised whereby the legal power of decision-making or the principal administrative responsibilities have remained in the hands of the foreign enterprise. 237/

240. The novelty of the present system of joint ventures in Latin America has two principal aspects:

(a) The elaboration of a "legal status" for this form of organization, with precise rules governing its internal composition and administrative system. The most important feature of these rules is that it is not considered sufficient (at least in the case of Argentina, Mexico and the Andean Group for the majority of the capital or even the majority of the shares carrying voting rights to be domestically owned. The principal objective of the mixed enterprise system is to ensure domestic control of decision-making through the participation of domestic investors in the capital and management. The priority assigned to this objective is clear, not only in the legal recognition of the fact that participation in the capital as a method of control does not suffice, but also in the fact that, in practice, local participation in projects that are considered particularly important tends to be exercised through State enterprises, i.e. through entities directly connected with the government. 238/

236/ In the case of Mexico, there is considerable experience of the use of this method to accede to pressure for domestic participation. See Business International, Mesa Redonda Mexicana, documento informativo, 1972, p.44.

237/ For legal techniques used to obtain internal control of an enterprise when having only minority participation in its capital (techniques employed in the case of international joint ventures) see R. Blough, "Joint international business ventures in less developed countries", in Institute of Private Development Abroad, New York, 1960; L. Cutler, "Joint ventures with foreign business associates, investors and governments", in Institute of Private Development Abroad, New York, 1959. Duke Law School, "International joint venture corporations: the drafting of control arrangements", in Duke Law Journal, pp. 516-530, 1963; M. Gordon, "Joint business ventures in the Central American Common Market", in Vanderbilt Law Review, vol. 21, 1968.

238/ An important role is played by certain government bodies such as the National Finance Corporation of Mexico, which has served as the main instrument of "Mexicanization" when the Government wishes to obtain rapid results (as in the case of the Mexicanization of the Anaconda subsidiary which was maintaining a copper monopoly, the tobacco and food industries, etc.); Industrias del Perú (INDUPERU), which, in addition to serving as an agent in Peru's programme for nationalizing basic industries, is also acting as an agency for new projects undertaken jointly with foreign subsidiaries; and the Venezuelan Petrochemicals Institute (IVP), which has introduced a "mixed enterprises programme" to guide its methods of participation according to the type of foreign enterprise concerned. For details on some of these joint enterprises, see chapter V.

At the same time, the demand for domestic control over decision-making is not necessarily a political objective or a manifestation of economic nationalism, but stems also from the consideration that in some cases the external legislative and administrative machinery is not sufficient protection against the danger of adoption by foreign enterprises of practices and decisions that may be prejudicial to national aims.

(b) The establishment of the mixed enterprise as the principal means for the entry of foreign investment. Many methods are used by States to secure the establishment of mixed enterprises. The main methods are the following.

(i) General and absolute obligation with a limited list of exceptions

241. This system is employed under Decision No. 24 of the Andean Group. Apart from activities where foreign investment is barred and provided that the projects concerned have been approved by the competent authority, there are two possibilities open to foreign investment. It can enter either directly through the establishment of a mixed enterprise or through the establishment of a foreign-owned enterprise but with an undertaking to sell to local investors a certain proportion of the equity capital necessary for it to become a mixed enterprise, within a period ranging from 15 to 20 years (art. 30). The sole legal antecedents for the latter possibility of gradual transformation are to be found in Peruvian legislation, 239/ which operates, in accordance with the relevant provisions of the law, on the basis of an agreement with the Government specifying time-limits, the stages of the process of share transfers (a specified minimum initial transfer being followed by two stages in which the local participation is progressively increased), rules for the transfer of shares and the progressive participation by domestic investors in the management of the enterprise from the start of its operations, and the method of determining the value of the shares transferred (art. 31). In any event, the system of transformation into mixed enterprises has been introduced mainly with manufacturing industry and sales to the Andean market in mind. 240/

239/ Article 16 of the General Industrial Law of 1970. An important source of inspiration for the system of gradual transformation was United States literature on foreign investment policies in Latin America. See, for instance, A. Hirshmann, "How to divest in Latin America, and why" in Essays in International Finance, No. 76, 1969; P. Rosenstein-Rodan, "Las inversiones multinacionales en el marco de la integración de América Latina" in Inter-American Development Bank, Las inversiones multinacionales en el desarrollo y la integración de América Latina, Washington, 1968, p. 66; R. Vernon, "Private long-term foreign investment in Latin America" in The role of foreign investment in the development of Latin America (ECOSOC), 1971, May 1969. Other background data should be mentioned too, such as the programme for "Chileanization" of the copper industry in the latter part of the 1960s.

240/ The only penalty for non-compliance with the transformation programme is loss of the advantages derived from the programme of tariff liberalization established under the integration scheme (article 32). The transformation programme is compulsory with two exceptions: enterprises exporting 80 per cent of their production to third countries, and enterprises in the primary commodities sector (mining, petroleum and forestry), public utilities, insurance, commercial banking, internal transport, advertising, radio and television, newspapers and internal marketing (articles 34 and 39).

(ii) General obligation subject to administrative review

242. The main example of this method is the Mexican law, article 5 of which establishes that in cases where legal provisions or regulations do not specify a percentage, foreign investment may not exceed 49 per cent of the equity capital of the enterprise and foreign investors may not in any way be empowered to determine the conduct of the enterprise. Furthermore, the participation of foreign investors in the administrative organs of the enterprise may not exceed their participation in its capital.

243. However, pursuant to the same article, the competent authority may decide on an increase in or reduction of the percentage mentioned in the preceding paragraph where it considers that the economy of the country justifies it. In practice, the Mexican system legalizes the method of negotiating the "Mexicanization" process, which the Government has handled in a flexible manner over the last 30 years. The law gives the competent authority two kinds of power in this connexion: first, it may issue general decisions increasing or reducing the proportion of foreign capital in a particular sector of the economy, 241/ and, secondly, it may authorize individual increases in foreign capital participation at the request of the investors. However, foreign investors are not required to set up a mixed enterprise immediately a decision to that effect has been taken. The traditional system in Mexico has been to place the Mexican-owned share of the capital in trust with a local bank. Up to now the Government has accepted this as a form of Mexicanization, except in the case of certain sectors such as petrochemicals and the extractive industries, despite the apparent serious doubts regarding the effectiveness of the power of the Mexican participation thus obtained. 242/

241/ The first decision issued by the authority specifies that the capital of assembly industries working for export may be 100 per cent foreign-owned (Boletín, 6 July 1973).

242/ A graphic example of the operation of the trust system in Mexico is to be found in the Business International information paper mentioned earlier (page 48): "The trust used by Bendix and a number of other companies is an interesting way of complying with Mexicanization without having to search for a doubtful local partner. The trust is usually so arranged that the bank acquires the voting power of the shares in question while the company keeps the share certificates entitling it to receive all dividends payable during the trust period. When the latter expires, the trustee or its securities division sells the shares, which carry both voting power and entitlement to a share of the profits. As the Mexican stock market has been unable to absorb new issues in the last few years and this situation may well continue for at least two more years in the view of far-sighted Mexican bankers and private business-men, the trust arrangement will continue to be a sound intermediate source prior to the placing of shares on the market, and there is no reason why it should not continue to be used for the purposes of Mexicanization ... The trust system also keeps companies out of the hands of unduly powerful local shareholders who are the only other alternative for rapid Mexicanization, since shares cannot be issued to the public from one day to the next."

(iii) Administrative powers to require the establishment of mixed enterprises

244. In *Argentina*, the Foreign Investment Law states that investment agreements may, where it is so stipulated by the Executive, provide for the conversion of the enterprise into an Argentine enterprise or into a mixed enterprise with a gradually increasing proportion of Argentine capital (art. 22). Renewal of contracts concluded with enterprises existing prior to the entry into force of the law may be denied by the competent authority, which may then require the conclusion of an agreement containing arrangements for the gradual conversion of the enterprises concerned into mixed or Argentine enterprises (Decree No. 413, art. 14).

245. In *Brazil*, there are no written rules or formal procedures concerning the establishment of mixed enterprises as a means of entry for foreign investments. In the last few years, however, the government has begun to apply, through its overall control of market access, a fairly stringent policy with regard to the capital structure of enterprises involved in large-scale projects for the industrial processing of domestic raw materials. One of the main examples is the Bahia petrochemical complex where "all the projects have a majority of domestic capital while foreign capital provides only a third of the funds, and furnishes the technology." Other sectors in which the Government seems disposed to apply the same formula are mining, iron and steel, banking and insurance. In several cases the projects have been organized in such a way that the majority of the capital remains in Brazilian ownership while the State retains a sufficient proportion to ensure, in principle, Brazilian control of the enterprise. 243/ In this connexion, State enterprises in the petrochemicals and mining sectors appear to play a significant role as promoters of this policy and also in counterbalancing the power of foreign companies in projects carried out as joint ventures.

(iv) Direct and indirect incentives

246. In addition or as an alternative to the techniques described above, Latin American governments often adopt different methods to encourage voluntary undertaking of joint ventures by domestic and foreign enterprises. As a rule these methods involve making the grant of certain incentives or the non-application of unfavourable treatment conditional upon appropriate organization of the enterprise.

247. The only country whose law expressly provides for this as part of the *terms of entry* for foreign investment is *Argentina*. Article 4 of that country's law establishes a basic distinction between the formation of enterprises with foreign capital and those with participation of both domestic and foreign capital, since the former have to be approved by the National Congress (which involves a public, political and probably lengthy discussion of the project) whereas the latter can be authorized directly by the Executive. Under article 7, moreover, preference is given to investment applications which include a programme for the gradual conversion of the capital of the foreign enterprise. 244/

243/ See the recent experience of Alcan, Hanna Mining, U.S. Steel, Sumitomo and other major multinational enterprises, in *Business Latinamerica*, 24 October 1974 and 16 January 1974. See also *Le Monde*, 19 September 1974.

244/ There is a similar provision in article 27 (b) of Venezuela's Decree No. 62/74 which provides that special consideration must be given to foreign investment projects which agree to transform themselves into Venezuelan or mixed enterprises within a shorter period than that specified in Decision No. 24 of the

D. Control of access to domestic markets and national economic resources

248. Among the main negative aspects of foreign investment in Latin America, the following three were regarded by most of the countries as special problems to be solved by appropriate means: (a) the tendency of foreign enterprises to concentrate their activities in strategic sectors of the economy and in industries with the fastest growth rates; (b) the disproportionate use of national economic resources and, in particular, of local savings through the credit system; and (c) the predominance of foreign enterprises among the recipients of industrial development incentives.

249. The above-mentioned problems were partly due to the lack of means of control over markets and to factors related to the difference in power between the foreign and the domestic enterprises. The lack of selective policies with regard to market access, credit distribution and the granting of industrial development incentives enabled the subsidiaries of international firms to make the most, in practice, of their greater financial resources and standing in competitive markets and this led to cases of abuse of economic power.

1. Determination of sectors reserved for domestic capital enterprises or mixed enterprises

250. Some of the new Latin American laws contain sector lists specifying the activities in which the participation of foreign capital is prohibited or limited. In Argentina, the general principle is that "the investment shall be in activities and geographical areas specified in order of priority by the Executive" (Law No.20,557, art. 5 (a)). Furthermore no permission is given for new investments in activities relating to defence and national security, public services, insurance and commercial banking, advertising, radio, television, mass media and domestic marketing services, activities reserved by law for State enterprises or Argentine enterprises (e.g. basic petrochemicals) and, except in special cases, activities relating to farming, stockbreeding, forestry and fisheries (article 6 (c)).

251. The system used in Mexico establishes a classification of activities (a) reserved exclusively for the State (petroleum and other hydrocarbons, basic petrochemicals, the exploitation of radioactive minerals and the generation of nuclear energy, some other mining, electricity, railways, communications and other activities as provided for in specific laws); (b) activities reserved for Mexican enterprises (radio and television, domestic road and air transport, forestry and gas distribution); and (c) activities in which minority participation of foreign capital is allowed up to the following maximum proportions: secondary petrochemicals and the motor vehicle parts industry - 40 per cent, exploitation of minerals under ordinary concessions - 49 per cent, exploitation of minerals under special concessions - 34 per cent. 245/

245/ Foreign investment law, articles 4 and 5. The main "specific law" is the Decree of July 1970 which specifies the majority proportion of voting shares to be held by nationals in the case of enterprises in the iron and steel, cement, glass, fertilizer, cellulose and aluminium sectors.

252. Decision No. 24 of the Andean Group provides that no new foreign investment will be permitted in the sectors of public services, insurance, commercial banking, domestic transport, advertising, commercial radio, television stations, newspapers, periodicals, and domestic marketing (articles 41 to 43). It also provides that, during the first few years of application of the régime, foreign enterprises may be permitted to operate in the basic commodities sector on a concession basis, providing that the term of the investment does not exceed 20 years (arts. 40 to 43). 246/

253. In the case of Brazil, the Constitution and some special laws establish limitations on the participation of foreign capital in certain sectors. Thus, for example, the development and import of petroleum is a State monopoly. The operation of air services, shipping services and commercial banks is reserved for enterprises with a majority of State capital.

2. Restrictions on access to credit

254. In some Latin American countries, one of the main areas of differentiation of treatment of enterprises according to the origin of their capital is the amount and terms of the credit they may obtain under the local financing system.

255. In Argentina, the law provides that, in every investment agreement, the supervisory authority shall stipulate the maximum local indebtedness incurrable by foreign investors which shall in any case be limited to short-term credit. 247/

256. In Brazil, Central Bank Decision No. 53/67 provides that at least 50 per cent of the credit operations of financial institutions shall be for the benefit of domestic firms (enterprises having their headquarters in Brazil and of which the majority of the capital is Brazilian). Moreover, official bodies may not extend credit to an enterprise the majority of whose capital and voting rights are held by foreigners until the operations of the enterprise have begun, except in the case of projects of outstanding importance to the national economy (by special permission of the Council of Ministers); nor may they grant credits for new investments in the fixed assets of such enterprises unless the investments in question are of outstanding national importance, as defined by decree of the Executive. The same rule applies to resources derived from public investment funds (Law No. 4,131/62, articles 38 and 39).

246/ As the situation in the different sectors may not be the same in all the member countries, the Common Régime allows the Governments to apply different rules. Some countries have therefore reserved the right to permit foreign investment in all or some of these sectors. This right was recently exercised by Colombia, which decreed the authorization of new investment in the banking and marketing sector and the continuation of control of enterprises in the basic commodities sector under the existing domestic legislation (Decrees No. 2,719 and No. 2,788 of 1973 and Decree No. 387 of 1974).

247/ This is understood to mean what is needed in order to meet business or operating requirements for a period not exceeding one year (Law No. 20,557, art. 17; Decree No. 413, arts. 30 to 32). In setting the limit of indebtedness, the supervisory authority is required to take into account the circumstances of each case, on the basis of the capital of the enterprise, plus its reserves.

257. In Mexico, there are at present no official restrictions on the granting of credit to foreign enterprises. However, the Ministry of Finance may fix the maximum proportion of credit which may be extended to enterprises directly or indirectly controlled by foreigners (Decree of 23 December 1970, article 2). [248]

258. In the Andean Group, article 17 of Decision No. 24 limits the access of foreign enterprises to domestic credit to short-term credit only, on terms and conditions to be prescribed in regulations to be laid down by the Commission of the Cartagena Agreement. [249] Meanwhile, some of the member countries have enacted legislation on this subject. In Peru, Decree No. 19,470 of 1973 provides that enterprises with a foreign capital participation exceeding 20 per cent may obtain loans for a term of more than one year only if the loans are intended for the financing of exports of manufactures. In Venezuela, a decision of the central Bank lays down the conditions on which credit may be extended to enterprises more than 51 per cent of whose capital is controlled by foreign enterprises.

259. In Uruguay, article 11 of the foreign investment law provides that enterprises whose capital is foreign-owned may not obtain medium- and long-term domestic credit, although they may, in special cases, be granted short-term credit.

260. It should be noted that financial restrictions are not placed only on domestic credit. Some countries prohibit or limit the provision of endorsements or guarantees for external loans arranged by foreign enterprises, either entirely, as in Argentina, [250] or by a limitation of official guarantees, as in Brazil [251] and in Decision No. 24. [252]

3. Restrictions on access to industrial development benefits

261. A principal feature of the new approach adopted in Latin American schemes to promote industrial development is the full or partial reservation, or the granting on a preferential basis, of the benefits of such schemes to domestic enterprises. The basic reason for this policy is the need to strengthen the market power of domestic enterprises and prevent foreign enterprises from benefiting indiscriminately and often unnecessarily from State incentives. As has already been mentioned, such discriminatory treatment may also be viewed as a policy aimed at encouraging foreign enterprises to model their organizational structure on that of mixed enterprises or enterprises under national control.

262. The Argentine industrial development law is probably the most developed system in the region in terms of differentiation of treatment. Its purpose is to strengthen nationally-owned industry and to ensure that powers of decision-making in the

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[248] Furthermore, upon notification through the Bank of Mexico, private banks may be required to restrict the amount of credit extended to enterprises controlled by foreign capital.

[249] These regulations had not yet been approved in early 1974.

[250] Law No. 20,557, article 25.

[251] Law No. 4,131, article 37.

[252] Decision No. 24, article 15.

industrial sector remain in Argentine hands. To this end, it provides that the advantages and benefits to which it refers are reserved to Argentine enterprises and mixed enterprises, as defined in the investment law. 253/

263. In Brazil, no explicit general distinction is made with regard to the nationality of enterprises that may benefit from development incentives, except that "the strengthening of private enterprises and, in particular, Brazilian private enterprises, whose competitive advantage should be increased both internally and abroad", and "the defence of Brazilian technology and the absorption of foreign technology consistent with the country's factors of production" are the basic guidelines of the industrial development policy (Decree No. 65,016, art. 20). The possibility of using certain development tools is, however, dependent on the capital structure of the enterprises concerned. Among these tools, the following may be mentioned: Legislative Decree No. 1,240 of 1972 or fiscal incentives for mineral exports, which provides that Brazilian shareholders must control the majority of the voting stock of the beneficiary enterprises; Decree No. 64,214 of 1969, which sets limits on repatriation of profits abroad and on the granting of incentives to enterprises with a majority foreign capital participation which are associated with the development scheme of the Department for the Development of the North-East; the Decree of 1970 establishing the Industrial Modernization and Re-organization Fund, which may give assistance only to domestic enterprises; and Decree No. 73,685 of 1974, which provides that the State, in awarding contracts for consultants' and engineering services, must give preference to Brazilian enterprises.

264. In Mexico, the industrial development system, which is set out in a number of different regulations, restricts the grant of most incentives to enterprises the majority of whose capital is Mexican. As is customary in Mexico, the discrimination in treatment is in some cases explicit and in others the result of administrative practice. Among the explicit restrictions are the rules laid down in the Decrees on industrial decentralization and regional development of November 1971 and July 1972, 254/ the Decree on economic development corporations and agencies of 1973,

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253/ The industrial development law is more specific, however, than the investment law in its definitions of enterprises of Argentine nationality and enterprises of foreign nationality. It also requires that: (a) in the case of companies, the majority of the shares or other capital holdings carrying voting rights be owned by persons domiciled in Argentina; (b) 80 per cent of the management and 90 per cent of the technical staff of the enterprise be Argentines domiciled in Argentina; (c) there be no stipulations in the regulations of the enterprise or under any contract compelling repatriation of capital, interest or dividends to a foreign country; (d) the enterprise be genuinely established in Argentina in accordance with the "principle of economic effectiveness"; (e) the enterprise be independent of any public or private bodies abroad; and (f) the enterprise's regulations or licensing or technical assistance arrangements contain no stipulations which restrict national ownership, technology, industry or trade. (Law No. 20,560, arts. 3, 16 and 17).

254/ These Decrees require the majority of the capital and the entire management and administration of the companies to be controlled by Mexicans.

the Decree of 1972 on incentives for the development of the motor vehicle industry, 255/ etc. The unwritten restrictions are probably more important. They relate to manufacturing programmes and import controls, which ensure protection on the domestic market for enterprises with a majority Brazilian shareholding by making imports subject to prior authorization and to implementation of the law on the development of new and necessary industries, which specifies the main tariff advantages. 256/

265. In the Andean Group, the provisions of Decision No. 24, except those relating to domestic credit, do not affect the right of the member countries to discriminate, where industrial development is concerned, according to the nationality of enterprises, except that the member countries may not accord to foreign investors treatment more favourable than that which they accord to national investors (article 50). Nevertheless, since, in accordance with the sub-regional strategy for industrial development, the enlarged market of the six member countries is the main instrument for the promotion of investment, 257/ reservation of the benefits of the tariff liberalization programme exclusively for goods produced by domestic enterprises or mixed enterprises of the member countries must be viewed as a discriminatory incentive (article 27). Consequently, enterprises established before the entry into force of the Common Régime must agree to conversion into mixed enterprises if they wish to enjoy the benefits of this programme (article 28).

266. The industrial development instruments of the six countries members of the Andean Group, except Peru, do not provide for significant discrimination against foreign enterprises. Under Peru's general industrial law, the incentives provided for in the law may be granted to foreign enterprises only if they agree to their conversion into mixed enterprises (article 16).

E. Administration of foreign investment control

267. In view of the extent of the areas subject to control in most of the countries, it is understandable that national legislation and policy should have generally envisaged a combination of methods directed towards both the structure and the functioning of foreign investment and designed to control the establishment and monitor the operations of foreign enterprises. It is also worth noting the use of mixed systems in which the traditional means of external control through legislation is supplemented by efforts to devise internal control methods by means of domestic participation in the decision-making bodies of the enterprises which are the recipients of foreign capital.

268. The administration of the control system poses perhaps a greater problem than that which might have arisen in a number of countries, such as the members of the Andean Group and Mexico, in securing legislative approval of the new rules on foreign

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255/ In this case, 60 per cent of the capital of the enterprise must be Mexican.

256/ See Secretariat of Industry and Trade, "Posibilidades industriales: instrumentos de promoción industrial", op.cit.

257/ Paragraph 1 of the preamble to Decision No. 24.

investment. 258/ The application of such a system requires a complex administrative apparatus of a level of sophistication similar to that required for the application of substantive regulations, but much more difficult to achieve. This problem is particularly important in the case of those countries that lack any substantial prior experience of dealing with the subject from a legislative standpoint and those whose national administration is, for various reasons, going through a phase of change and adjustment - in other words, the majority of Latin American countries. It is not, therefore, surprising that at the current stage it is virtually impossible to analyse adequately the effectiveness of the various systems of control, when almost all of them have only very recently been brought into force. Practically all the countries concerned are still only beginning to introduce new regulations in this field, which can accurately be described as experimental. 259/

269. The brief analysis of major trends and problems in application set forth below should therefore be regarded as a tentative description designed to bring out some important trends and aspects of a particularly dynamic situation.

1. Institutional arrangements

270. The existing control mechanisms vary appreciably from country to country - a situation which is doubtless due not only to differences in political and economic approach, but also to the diversity of the administrative structures and legal principles obtained in the different States. However, all the systems display the same tendency towards a certain decentralization of administrative controls away from a central framework within which the main instruments of State action are concentrated. The administrative control apparatus normally consists of a small group of major organs specializing in direct control of foreign investment (almost invariably referred to in foreign investment legislation as "enforcement authorities" or "competent organs") whose activities are complemented by those of other bodies which, because of the particular nature of the task, are entrusted with the application of special aspects of the control system.

271. The "major" organs are generally responsible for controlling the inflow, functioning and outflow of foreign investment. The nature and responsibilities of these organs vary according to the individual country's concept of how such control should be exercised.

272. In Argentina and in the Andean Group where special importance is attached to the prior evaluation of investment projects, the authorizing agencies are generally

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258/ See M. Wionczek, "La reacción norteamericana ante el Régimen Común a los capitales extranjeros en el Grupo Andino" in Comercio Exterior, May 1971, pp. 406-408. As regards Mexico, see the article by S. del Villar in Comercio Exterior, October 1972

259/ In some cases - e.g. the Andean Group countries - a number of national regulations to give effect to the Common Régime relating to Foreign Investment were still lacking in mid-1974.

connected with the economic planning or industrial programming sectors. 260/ In almost all these systems, however, control of the outflow of funds to foreign countries, which is generally entrusted to the Central Banks, is also an important function.

273. In Brazil, on the other hand, whose system is geared more to regulating the outflow than to controlling the inflow of capital, the major role is played by the Central Bank's Office for the Control and Registration of Foreign Capital, with which investors must register in order to be able to transfer funds abroad.

274. In Mexico, however, the entire system rests on the control of investment inflows. In order of rank, the highest body is the National Commission on Foreign Investment, which is responsible for dealing with the most important matters arising in connexion with the application of the law and for co-ordinating the activities of the other bodies. However, "day-to-day" control over foreign investment appears to be exercised by the Department responsible for the particular sector in so far as authorization of investment is concerned - in particular the Department of Industry and Trade, which is responsible for the operation of the Registry of Foreign Investments.

275. The institutional arrangements for controlling foreign investment are complemented by the activities of other agencies responsible for administering various Government policies. In the area of control over the organizational structures of foreign investment, and particularly over the capital structure of enterprises, the functions of the Company Supervision Authorities (Superintendencias de Sociedades) which operate in most of the countries of the region could be important. Despite the fact that their normal function is to ensure compliance with legal requirements, these agencies may in some cases be converted into genuine instruments for the control of foreign investment. An example of this type is the Companies Supervision Authority of Ecuador which, applying its powers of company surveillance, came to require all foreign enterprises to show proof of prior authorization by the competent body (the Ministry of Industry, External Trade and Integration), observance of the rules relating to mixed enterprises and the non-acquisition of Ecuadorian enterprises, and the conversion of bearer shares into registered shares.

276. Another important aspect of control of the entry of foreign investment, which requires decentralized administration, is control of the investment of non-monetary assets. Plans to invest equipment and machinery generally have to be examined in advance by bodies responsible for determining that similar items are not produced locally 261/ and the goods have to be valued.

260/ Examples of this type of agency are the Department of Economic Programming and Co-ordination in Argentina, the Production Development Corporation in Chile, the National Planning Department in Colombia, the Committee on Foreign Capital, Industrial Property and Technology of the Ministry of Industry in Peru, and the Office of Foreign Investment of the Ministry of Development in Venezuela.

261/ Examples of such bodies are the Capital Goods Committees of the Department of Industry in Argentina and Corfo in Chile, the National Registry of Manufactures in Peru and the advisory and consultative committees of the Department of Industry and Trade in Mexico.

277. In a number of countries, as has already been mentioned, the agencies responsible for administering industrial development systems perform the important task of determining the allocation of incentives on the basis of the "economic nationality" of the participating enterprises. In some cases, these agencies may also act as centres for the selection and authorization of foreign investments. In Brazil, the Industrial Development Board (CDI) is, in practice, the body which decides whether to accept or reject most new investments in the industrial sector: the foreign investment concerned is registered with the Central Bank only after being approved by CDI (in those cases where approval is necessary) and solely for the purpose of certifying that it is genuine and has actually been effected. In Mexico, too, the Department of Industry and Trade and its subsidiary bodies may perform the dual function of administering incentives and controlling the admission of foreign investment, since they are responsible for ensuring compliance with the rules concerning the maximum participation of foreign capital in enterprises, a subject with which the Commission on Foreign Investment is, in principle, concerned only when the question of increasing or reducing such participation is under discussion. The administration of domestic credit control is also generally decentralized. 262/

2. Implementation problems

278. Despite the very brief experience of application of the new foreign investment régimes and the difficulties of interpretation owing to the number of bodies involved in each country, it is possible to identify some of the problems which the application of the various control systems poses. Some of the most important of these problems are examined below.

(a) Control of the entry and operations of foreign investment

279. In so far as the desired objective is selectively to control all direct foreign investment, the effectiveness of the control will largely depend on the ability to canalize the inflow of investments and also on the existence of a system for controlling the outflow of capital and profits (or alternatively of a mechanism which enables avoidance of the official entry channels to be adequately penalized). The method employed in most of the countries is to centralize the authorization and registration of investments and to use foreign exchange control as a means of exerting pressure on enterprises to conform with the requirements. In some cases, however, provision is even made for different entry channels according to the nature of the investment (Chile) 263/ or according to the exchange area chosen by the investors

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262/ The Central Bank (Argentina, Brazil, Chile and Peru) or the banks supervision authority (Colombia and Ecuador) may be responsible for this aspect.

263/ In mid-1974 there were two systems governing the admission of foreign investment in Chile: article 16 of Decree No. 1,272/61 administered by the Central Bank, and the Statute of Investors (DFL 258/60), for whose application Corfo is responsible. These systems have continued in operation since the entry into force of Decision No. 24.

(Ecuador). 264/ Under the latter system it may be difficult to exercise strict over-all control of foreign investment access. In some countries of the region, however, there is no exchange control of any kind. Where this is the case, the effectiveness of prior authorization requirements depends on the extent to which the failure to obtain authorization entails for enterprises the loss of important benefits or the application of particular penalties. In the case of Mexico, the possibility of denial of protection and development measures (especially import permits and tariff protection) is probably a more important motivating factor than the application of any of the special penalties provided for in the foreign investment law. 265/ In Venezuela, which also has no foreign exchange control at present, the law provides that the rights of foreign investors shall take effect only from the time when the relevant applications are finally approved and registered. 266/

280. Decentralization of the evaluation machinery as practised in some countries, although desirable since it permits specialization of controls, may result in administrative inconsistency or overlapping. In Mexico, such situations might occur in cases where the proportion of foreign holdings in a company's capital rises above the percentage authorized by the law and where authorization is given to purchase domestic enterprises. 267/ In Peru, the multiplicity of authorizing agencies (each Ministry is responsible for its particular sector) and the fact that the two functions of registering foreign enterprises and supervising their activities (the responsibility of the Central Bank) are carried out more or less separately, may lead to similar problems.

264/ In Ecuador there are two possible means of entry for foreign capital: the official foreign exchange market controlled by the Government, which guarantees the repatriation of capital and the remittance of profits; and the free market (D.S. 1,740/71, article 2).

265/ For example, failure to register is penalized by prohibition of the distribution of dividends, but Mexico has no agency responsible for company supervision through which this provision could be enforced.

266/ The restrictions imposed by Decision No. 24 on remittances abroad, which in Venezuela also cover the distribution of dividends to foreign investors, are enforced by means of special penalties for infractions of the law: mandatory reimbursement of the amounts involved to the Treasury as damages, suspension of permits for operations of any kind and, possibly, cancellation of the registration (if it has been approved) and sale of the shares to Argentine investors (Decree No. 62, articles 68-70).

267/ In practice, the Department of Industry and Trade has generally required foreign enterprises making new investments to adjust their capital structure to the rule providing for a 51 per cent Mexican holding and to form a mixed enterprise within a prescribed period. However, investors may approach the National Commission on Foreign Investment, which is empowered to authorize a larger share of foreign capital, to extend the time-limit for the conversion of the capital and to allow investors to "Mexicanize" it through methods such as the establishment of trusts. Moreover, in the case of granting of permission to purchase shares held by Mexican investors, both the Commission and the Departments responsible for the sector concerned must intervene in turn - an arrangement which, in practice, appears to have resulted in some conflicting solutions during the initial implementation of the law.

281. It is necessary to point out, moreover, that the existence of controls on the repatriation of capital and the remittance of profits, and the resultant obligation to register investments, do not necessarily ensure the application of selective criteria in controlling the entry of foreign investment. An example of this is provided by Brazil, where the main functions of the industrial development bodies - to evaluate projects in terms of their contribution to Brazil's industrial development - may result in reduced account being taken of essentially qualitative factors such as those connected with the economic power of foreign enterprises. 268/

(b) Control of the acquisition of domestic enterprises

282. The major problem in applying measures to control foreign acquisition of shares or capital holdings from domestic investors arises from the possibilities of circumvention of the controls. Firstly, as has been seen, the legislation of the countries concerned - with the exception of Mexico and the partial exception of Argentina - contains no provisions prohibiting other methods of taking over enterprises, such as the acquisition of assets and the usufruct and pledging of shares. In addition, if no clear rule is laid down regarding the position of local mixed enterprises acquiring shares from domestic investors, certain take-over methods based on the establishment of holding companies or interrelated companies with differing degrees of foreign participation may nevertheless again begin to be used. 269/ In almost all cases, control over the capital structure of enterprises is exercised through the requirement that the shares be registered - a requirement which may be either general or limited to shares held by foreigners. However, in countries where "name-borrowing" is sometimes practised, a requirement that shares be registered is probably inadequate as a means of control and does not necessarily prevent the timely transfer of shares to ensure that the companies supervisory authority does not step in. Finally, the domination of enterprises by methods which do not affect their ownership structure or assets - such as contractual arrangements in the area of external financing, the transfer of technology, etc. - is generally subject to control by authorities other than those which are responsible for the control of foreign investment.

(c) Control of organizational structures

283. The main difficulties in controlling the organizational structures of foreign investment lie in the basically evolving and fluid nature of the definitions of mixed, foreign and domestic enterprises. The most difficult point to deal with in practice is the very one on which legislators have placed the greatest emphasis: the retention of decision-making power in the hands of domestic investors. The limited information available regarding the initial period of application of the régimes of some countries, such as Mexico and the countries implementing Decision No. 24, would appear to indicate that the competent authorities have so far adopted a fairly flexible approach in interpreting the legal requirements, frequently confining their attention to the capital structure of enterprises, the provisions

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268/ For a criticism of the basically development-oriented criteria applied by Brazil's Industrial Development Council in deciding whether to approve new investments, see Jornal do Brasil, Revista Económica, 18 April 1974.

269/ In Colombia, the participation of a mixed enterprise in another local enterprise requires prior authorization if the participation is paid for out of profits carrying entitlement to transfer abroad. In the absence of authorization, such participation is regarded as "domestic capital under foreign ownership".

of their statutes and the composition of their top management. This would seem to leave open various possibilities for external control by foreign investors through complementary arrangements with mixed enterprises (such as those mentioned in the preceding paragraph) and even for some methods of internal control through certain administrative arrangements. 270/

(d) Control of access to domestic markets and national productive resources

284. The main difficulties here may arise from the fact that industrial development, credit allocation and other policies are administered separately from foreign investment control policies. In some countries the general rule setting limits to the internal indebtedness of foreign enterprises has been formulated or applied in a manner which was not fully co-ordinated with the authorities competent in matters of external investment. In addition, the restrictions on the granting of domestic credit to foreign enterprises may not be adequate to prevent the use of domestic savings through other methods, such as suppliers' credit. It is important to point out at this juncture that one of the possible reasons for the lack of co-ordination between the "complementary" governmental policies regarding the treatment of foreign investment and the activities of the "principal organs" is the disparity between the autonomy and administrative resources enjoyed by the latter, which have generally acquired the status of government agencies only recently, and those enjoyed by the bodies responsible for formulating and applying those policies on the basis of procedures and machinery which were firmly established many years ago.

270/ Some techniques for obtaining effective control of the management of mixed enterprises are more easily monitored than others. For instance, the issue of two sets of shares with different rights attaching to each, in respect of either voting itself or of the number of votes, is easier to supervise than is the practice of apportioning administrative functions in such a way that effective control remains in foreign hands, although the major decision-making bodies and official decision-making machinery remain in the hands of nationals of the country concerned. For some examples of cases of this kind, see Friedmann and Beguin, op.cit., and Business International, Recent Experience in Establishing Joint Ventures, op.cit., especially pp.11-25.

Chapter V

CONTROL OF RESTRICTIVE BUSINESS PRACTICES IN INTERNATIONAL LICENSING AGREEMENTS

285. In Latin America, State intervention in this area was, in several respects, an even more significant phenomenon than the modification in the attitude towards foreign investment. While the entry of foreign capital had in some countries been the subject of government attention, albeit only for the purposes of regulating the furnishing of guarantees and the provision of incentives, the conclusion of licensing arrangements was regarded as an area reserved to the "free will" of the contracting parties, in accordance with the principles of liberty of contract established in the various commercial codes. There were no known cases of conflict between contracting parties arising, for instance, from abuses committed by or restrictive practices engaged in by licensors. Had anything of the sort occurred there would in any case have been no way of remedying it, not even through application of the anti-monopoly laws in force in some countries, neither the texts nor the enforcement authorities of which appear to be geared to penalization of such practices, at least in so far as international agreements were concerned.

286. It was only in the late 1960s that any significant efforts were made to change the situation described above, in parallel with the other changes in the industrial development strategies already mentioned, particularly the new approach to foreign investment. The first countries to take specific measures were Chile and Colombia. In July 1967, the Board of the Central Bank of Chile, under its powers in matters of foreign exchange and the authorization of external remittances of foreign currency, decided to set up a Commission to review royalty agreements. (Decree No. 1,272 of 1961, articles 20, 30 and 40). 271/ In Colombia, legislative Decree No.444 of March 1967 established a Committee responsible for approval of agreements involving foreign transfers in respect of "royalties, use of trademarks, patents, etc.," which had thenceforth to be registered with the Foreign Exchange Office of the Central Bank.

287. Initially, these bodies concentrated on carrying out financial analyses of agreements, in other words, of the impact of royalty payments on the balance of payments. In time, however, they took over other functions, especially in the area of technical evaluation and negotiation of agreements. The experience gained by these bodies, and particularly by the Colombian Committee on Royalties 272/ was an important factor leading to adoption of the more complex and systematic régimes which began to appear at the beginning of the present decade.

271/ A 1963 decision of the Central Bank required the registration of licensing agreements. The policy of approving or rejecting agreements began with the establishment of the Committee, although the latter's function was primarily to advise the Executive Committee of the Central Bank, which then took the decision.

272/ The decree setting up the Committee on Royalties laid down that that body should take account, inter alia, of the following criteria: (a) value of the contract to economic and social development and its relationship to any foreign currency payments which the contract entails; (b) the possibility of making the product under similar conditions without royalty payments, by the use of ordinary processes capable of being applied for that purpose in accordance with modern technological advances and the development of local industry; (c) public treaties entered into by Colombia and prevailing international practices in that field; (d) effects of the contract on the national balance of payments; (e) extension of the market potentially open to the products manufactured under the contract, and (f) period of validity of the patent (Decree No.444, article 102).

288. There are at present four different systems of legislation on this question in nine Latin American countries: that of the six members of the Andean Group, where Decision No.24 of the Cartagena Agreement Commission has been in force since June 1971; that of Argentina (Law No.19,231 of September 1971 and the implementing regulations introduced by Decree No.6,187 of December 1971); that of Brazil (Industrial Property Code of December 1971, articles 29-32 and 90); 273/ and that of Mexico (Law of 28 December 1972).

289. The legislative devices used in the four systems mentioned are all different. Decision No.24 established a joint régime for foreign investment and the transfer of technology, having regard to the objective of harmonizing the legislation of the various countries and to the fact that the use of foreign technology is, especially in the Andean sub-region, a phenomenon almost always associated with the investment of external capital. 274/

290. Both Argentina and Mexico, which have a greater degree of legal and administrative decentralization, preferred to adopt specialized régimes to deal with this matter. In Brazil, on the other hand, the regulatory system consists of a body of rules covering various different subjects: the industrial property law, the foreign investment law, the tax legislation and, of particular importance, the regulatory powers conferred upon the National Institute of Industrial Property (INPI) by Law No.5,648 of 1970.

291. Despite their differences of form, the four Latin American systems may largely be viewed as different expressions of one and the same pattern of action on the subject. They contain a number of common principles concerning the methods and forms of regulation and government intervention. These principles are examined below.

292. The first principle relates to State intervention. It is based on the view that, in the case of agreements between foreign enterprises and their local subsidiaries, there is generally no contract in the economic sense because the two parties involved are not separately autonomous; and, in the case of agreements between independent enterprises, these reflect an inequality in the negotiating power of the two parties. Consequently, the principle of intervention is not aimed at eliminating negotiation, but, rather, at strengthening it by making the government either a "party" (in cases where there is no other way of representing the national interest) or a "protector" of the local enterprises with a view to increasing their bargaining power having regard to its own interests and certain national objectives.

293. The second principle, which gives content to the first, relates to the evaluation of the contract in question. It implies, in the first place, the possibility of approval or disapproval; and, secondly, the application, in the case of technology agreements, of a system of cost/benefit analysis to guide the government in reaching its decision.

273/ Strictly speaking, Brazil already had some important rules concerning the registration of agreements (Law No.4,131 of 1962), their duration (Decree No.53,451), tax deductions (Ministerial Decree No.436 of 1958), etc.

274/ See "Policies relating to technology of the countries of the Andean Pact: their foundations - A study by the Junta del Acuedo de Cartagena" (TD/107, UNCTAD III).

294. The third principle has to do with specific control of the restrictive clauses in licensing agreements, in other words those stipulations which impose on the recipient obligations in matters not directly connected with the object of the agreement or which, if connected with it, affect the recipient's power of decision or subject him to domination by the transferring enterprise. Special attention will be devoted to this aspect in the analysis which follows.

A. General conditions in control of the transfer of technology

295. The main formal requirement for the transfer of technology is prior approval and registration of contracts. Contractual agreements are also subject to certain legal formalities designed to ensure the soundness of the transactions involved.

1. Registration of contracts

296. The requirement to obtain approval and registration of contracts is mandatory in Argentina (Law No. 19,231, article 2), Brazil (Law No. 4,131, articles 3 and 9), Mexico (Law on the Transfer of Technology, articles 1, 2 and 4) and Decision No. 24 (articles 6, 18 and E transitional).

297. The methods adopted to ensure compliance with the registration requirement vary from one set of laws to another. In Argentina, failure to register a contract renders it legally invalid with no right of application to the courts for its enforcement (article 5); furthermore, no payments or remittances abroad are allowed unless the contracts have been registered (article 12). In Brazil, registration of contracts (relating to industrial property) with INPI is compulsory if they are to be legally valid (Law No. 5,572, article 30) and registration with the Central Bank is necessary (in every case) if foreign remittances are to be made (Law No. 4,131, article 9). In Mexico, registration is obligatory for contracts to have legal effect and be enforceable in the courts (article 6). The penalty consisting in the prohibition of remittances abroad, which is inoperative in Mexico owing to the lack of foreign exchange controls, is replaced by the withholding from enterprises which fail to register contracts of the benefits, incentives and facilities provided for in the industrial development laws and other instruments (article 5). Decision No. 24, on the other hand, contains no measures for ensuring the registration of contracts. However, under the legal regulations in force in several of the countries, registration is a prerequisite for obtaining authorization for remittances abroad. [275]

298. There is an important difference between the systems applied in Argentina and the Andean Group on the one hand and those of Brazil and Mexico on the other. The difference lies in the scope of the contracting parties' obligation to register. The Argentine law confines registration to contracts "under which persons or entities domiciled in Argentina ... are liable to make payments or render a consideration of any other kind to persons resident abroad or foreign entities" (article 2). Decision No. 24 refers in general terms to "Any agreement relating to the import of technology" (article 18). It may be inferred from this that contracts concluded between persons domiciled in the country which do not directly involve the import of

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[275] Chile, Central Bank Circular No. 1,932 of 1972, art. 9; Colombia, Decree No. 444, art. 102; Decree No. 688, art. 6; Decree No. 1,234 of 1972; Peru, Supreme Decree No. 001-71-IC-DS/71, art. 51 and 52 and Legislative Decree No. 18,999, art. 2(b); Venezuela, Decree No. 62 of 1974, art. 59 and 63.

technology or payments abroad would be outside the scope of Government control. This would make it possible to evade the control of foreign technology through the establishment of local companies as intermediaries. In Brazil, on the other hand, registration is compulsory for all licensing contracts, and the registration system has been designed so as to facilitate examination of the capital links between enterprises. 276/ In Mexico too, the obligation to register applies to both domestic enterprises and foreign enterprises domiciled in Mexico, whether they are the suppliers or the recipients of the technology (article 3).

2. Contractual formalities

299. There are generally various legal formalities which must be complied with, especially when industrial property rights are involved. These requirements relate to the drafting of the contract in the language of the country and authentication of the signature of the foreign parties, publication of the contracts, 277/ verification of the validity of the patents which are the subject of the license, etc.

B. Control of restrictive practices connected with international licensing agreements

300. Contrary to the method employed in drafting the anti-monopoly laws in force in some Latin American countries, control by the Governments of the region of restrictive practices connected with licensing agreements is based on the prior accomplishment of empirical investigations into the existence and forms of such practices in the various countries. Such studies first highlighted the existence of quite an extensive area of inter-company relations in which the wielding of economic power and the abuse of positions of dominance were tried out in relative freedom. Almost all the practices brought to light consisted of contractual arrangements, usually quite specific, which laid down the rights and duties of licensors and licensees and included conditions that clearly restricted competition and as such were specifically prohibited by the laws of the countries of origin of all the parties benefiting from them. 278/ On the other hand, the Latin American anti-monopoly laws have never provided the foundations for State action in this sphere, whether because of gaps in its coverage, lack of interest on the part of those adversely affected by monopolies or the limitations inherent in the context of the laws in those countries in which such legislation does exist. Furthermore, restrictive practices in licensing agreements appeared to be linked with a set of problems that, in many respects, differed from those connected with competition. Such practices were not simply regarded as being undesirable because of their effect on the market but were looked at mainly from the standpoint of the wider objectives of national planning. In particular, these abuses were seen as part of the overall problem of foreign domination in the region and, in the majority of cases, were found to be linked with the investment of foreign capital.

276/ See items 1.16 and 1.17 of the form mentioned earlier.

277/ This obligation is established in the Argentine law (art. 16) as the basis of the right of third parties which may be affected to oppose registration.

278/ See, among other studies, OECD "Restrictive business practices relating to patents and licences," 1972; Ibid., "Guide to legislation on restrictive business practices".

301. Consequently, restrictive practices were considered not so much from the angle of the private cost/benefit balances they entailed for the parties to a contract - in fact, it may be assumed that, in many instances, technological dependence laid the foundations for a recipient enterprise's competitiveness in the local market 279/ - but rather in terms of the extent to which they might affect the economic and social interests of the countries in which they were applied.

1. The legal framework of the system of control

302. The Latin American countries have employed special methods to control restrictive practices of this type. In the systems in force in the region, such control either forms an integral part of the laws regulating the international transfer of technology or is entrusted to the bodies responsible for applying these laws or the relevant policies.

303. The legal technique used in the systems of control is based on a classification of the various types of restrictive clauses. This classification includes such categories of traditional restrictive practices designed to control market power as territorial restrictions, tie-in clauses, price-fixing and other types of vertical arrangement. Contrary to the approach adopted in the anti-monopoly legislation, however, the definition of the conduct to be controlled is basically descriptive and in general declaratory, 280/ formal legal concepts never being applied in that legislation or any common requirements taken into account as evidence of intent or as proof of the effects produced by the restrictive practices. The method of control employed in the various national régimes may be described as typically preventive and applied to "actual" conduct as reflected in the various contractual arrangements.

304. The above factors make it difficult to determine the real extent of the area controlled by the national systems. The lack of legal stringency in many of the definitions is due to the experimental nature of the control machinery, which is designed to allow the executing authorities sufficient flexibility of interpretation, so as to cover all the forms which an eminently variable and dynamic phenomenon may take in practice. 281/

279/ On this aspect, see the study by F. Sercovitch, "La transferencia de tecnologia en la Argentina", an unpublished doctoral thesis, 1974.

280/ This characteristic is explicitly laid down in some cases, such as Decision No. 24, which provides for control over "other stipulations of equivalent effect" to those described (art. 25(f)). In another case, that of Argentina, the same result is achieved by defining certain practices such as those "where the rights which are granted permit the direct or indirect control or manipulation of the country's production, distribution, marketing, investment, research or technological development" (Law No. 19.231, art. 3(d)).

281/ According to a lawyer with much experience in preparing international licensing contracts, "the ingredients of a successful licence requires the utmost care in selection and presentation. The mixing *en casserole* to produce an agreement which successfully meets the many problems currently afoot in the licensing field affords considerable scope for the creative lawyer *cum chef de cuisine*. Sad to say, the delicacy of the *soufflé* may not be readily appreciated, due to a lack of sophistication about the legal aspects of licensing on the part of many of the "consumers" of the lawyer's efforts" (Robert Jones, "*Fundamentals of international licensing agreements and their application in the European Community*", London, 1973, mimeo, page 47). See also the UNIDO instruction manual for negotiating international licensing contracts, "Licensing agreements for various contracts", UNIDO/FSIO, 23 April 1972.

305. Any examination of the system for controlling restrictive clauses will necessarily entail consideration of two aspects: the legal frame of reference which serves as a foundation for governmental decisions, and the policy that has developed in administrative practice, putting flesh on the bones of the legal framework.

306. The table below gives a comparative picture of the main characteristics of the legal framework applicable in the four existing control systems in Latin America. The restrictive practices have been classified in terms of the categories and patterns mentioned and described in various empirical studies on the subject. [282]

307. The methods of control have been classified in terms of three approaches or basic criteria encountered in the systems analysed. The first is the absolute prohibition of the restrictive clauses. The second criterion is prohibition in principle, subject to more or less carefully defined exceptions. The third is optional prohibition, at the discretion of the competent authority.

308. Although the list of restrictive practices considered in the table is not exhaustive, it does show that some categories are not specifically controlled in most of the systems. There are gaps in the rules, e.g. the case of restrictions continuing after the expiry of the licensing agreements. The table reveals that the largest number of prohibitions and controls relate to clauses restricting exports and to the various types of tie-in clauses, especially those affecting the licensee's purchases and sales. [283]

309. On the other hand, except in the case of the Brazilian legislation - the most summary but seemingly also the most stringent as regards the types of behaviour covered - the control systems tend to use mixed methods combining both strictness and flexibility. The greatest flexibility was to be found in the Argentine régime until its virtual amendment as regards restrictive clauses by Decision No. 119 of 1973; [284]

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[282] For information on the various kinds of restrictive clauses in international licensing contracts, derived from the experience of the developing countries, reference may be made to the: "Draft Code of Conduct on Transfer of Technology", Report of the Working Group, Pugwash Conferences on Science and World Affairs, PWG/CODE/5, Geneva, 1-5 April 1974; UNCTAD "The Role of the Patent System in the Transfer of Technology to Developing Countries" op.cit., pp. 46-66; "Restrictive Business Practices in Relation to the Trade and Development of Developing Countries, Report by the Ad Hoc Group of Experts",UNCTAD, TD/B/C.2/119.

[283] The emphasis on control of this type of clause is quite understandable, since the empirical studies referred to earlier confirmed the predominance of such provisions in the licensing agreements examined.

[284] The Argentine law institutes the optional prohibition method as the general rule for the control system (art.3). To all intents and purposes, however, criterion seems to have been amended by Decision No. 119 of the Department of Industrial Development which under the powers conferred on it by the law, has required that any existing contracts whose validity it is proposed to extend until 31 December 1974 must eliminate all but one of the categories of clauses covered by the law. On the other hand, Law no. 20,560 of 1973 on industrial development provided (art.18) that: "The following shall not benefit from promotional treatment: (a) enterprises whose regulating contracts or licensing or technical assistance allongements contain stipulations which restrict national ownership, national technology, national industry or national trade, limit exports or contravene the legislation which is in force on the date of application for acceptance". A similar provision was contained in the Readjustment Régime for the Automobile Industry (Law No. 19,135 of 1971, art.7, para.(g)).

Table

METHODS OF CONTROL OF RESTRICTIVE CLAUSES IN LICENSING AGREEMENTS

(according to legal provisions in force in Latin American countries)

	ARGENTINA	BRAZIL	MEXICO	ANDEAN GROUP (Decision No.24)
1. **Limitation of exports**	AP Dec.119, 2 a	AP L.5772,29-2&90-2 1/	PE LTT,7VII 2/	PE Art,20, fine & 25 a
2. **Tie-in clauses**				
2.1 Obligation to obtain supplies from a given source	AP Dec.119, 2 c	AP L.5772,29-2 1/	PE LTT,7VI 3/	PE Art.20, a & 25 b 4/
2.2 Obligation to sell to licensor or use his distribution channels	OP L.19,231, 3 d	AP L.5772,29-2&90-2 1/	PE LTT,7IX & XII	AP Art.20 e
2.3 Obligation to grant back inventions or improvements	AP Dec.119, 2 b	AP L.5772,29-2 1/	AP LTT,7IV	AP Art.20, F.
2.4 Obligation to accept other licences				
2.5 Obligation to employ personnel of the licensor			PE LTT.7X 3/	AP Art.20, a & 25 c
2.6 Ban on obtaining other licences	OP L.19,231,3 - d		PE LTT,7VIII 3/	AP Art.20 - d
3. **Quantitative restrictions**				
3.1 Price-fixing	AP Dec.119, 2 d		PE LTT,7XI 3/	AP Art.20-b & 25 c
3.2 Limitations of output or sales	OP L.19,231, 3 d		PE LTT,7XI 3/	AP Art.20 —c
4. **Post-expiry restrictions**				
4.1 Limitation on the use of the subject matter licensed after expiry of the patent or agreement				
4.2 Secrecy or confidentiality clauses				
5. **Extension of jurisdiction or application of foreign law**	AP Dec.119, 2 c		AP LTT, 7 XIV	AP Art.51

SYMBOLS AND NOTES

AP: Absolute prohibition

PE: Prohibition with exceptions

OP: Optional prohibition

1/ For patents and trade marks only.

2/ Prohibited when the restriction is deemed contrary to the national interest.

3/ May be allowed if the technology is of particular importance to the country.

4/ Acceptable in exceptional cases specified by the recipient country, provided that they relate to markets outside the sub-region.

SOURCE:

Argentina: Law No.19,231 of 1971 on the transfer of technology:
Decision No.119 of 1973 of the Department of Industrial Development
Law No.20,557 of 1973 on foreign investment.
Brazil: Law No.5,772 of 1971 on the Code of Industrial Property
Law No.4,131 of 1962 on foreign capital.
Mexico: Law of December 1972 on the transfer of technology.
Andean Group: Decision No.24 of the Commission of the Cartagena Agreement, December 1970.

this flexibility stemmed from the optional nature of the prohibitions, whose application was subject to decision by the competent authority.

310. In Mexico, however, the system is based on the separation of clauses into two groups according to whether they may or may not be "exempted" from the legal prohibition. The basis for exceptions to the law (the "national interest") is in any event sufficiently broad to give the system a certain degree of flexibility. The Andean Common Régime, although based on the principle of absolute prohibition, is flexible in the case of two of the most important categories of clauses: those relating to the exports and the supplies of the licensee enterprise. However, this flexibility is not like the broad flexibility adopted in the Argentine and Mexican laws, but is limited to some clearly identified exceptions.

311. Finally, it may be noted that the legislative framework which the countries use for the control of restrictive clauses presents some elements of decentralization. A case in point is that of the Andean Group whose Common Régime calls for the issuance of regulations by the member countries. In Argentina and Brazil, the control of some restrictive practices, especially those connected with the payment of royalties abroad, is incorporated in the legislation on foreign investment. In Mexico where certain types of restrictive practices used to be covered by the industrial development legislation, 285/ all the existing controls have now been centralized in the new law.

2. Policies for controlling the different types of restrictive clauses

312. The legislative framework examined above is merely the starting point for governmental intervention in this field. The control policy seems to have been devised as a process permitting the adoption of different approaches according to circumstances and the choices offered by the over-all negotiation context, of which, in the final analysis, restrictive clauses also form a part.

313. It is therefore essential to examine, together with the laws and regulations in force, the "jurisprudence" developed by the competent authorities. Unfortunately, it is not easy to make a comprehensive study of this subject owing, first, to the limited experience gained since the very recent approval of almost all the systems of control and, second, to the often confidential nature of such information, which is explained by the governments' need to use the control rules as an additional negotiating instrument where transfers of technology are concerned.

(a) Limitation of exports

314. Clauses which limit exports are broadly prohibited under the systems adopted in Argentina, Brazil, Mexico and the Andean Group. The Argentine provisions on the subject are the most comprehensive as regards the territorial restrictions imposed in that they refer not only to the prohibition of exports but also to clauses which make the right to sell subject to foreign authorization or to any other equivalent

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285/ For example, article 22 of the Decree of July 1972 on industrial decentralization in addition to imposing limits on the amount of royalties that may be paid abroad, provides that the incentives to which the decree refers will not be granted where the agreements impose export limitations that are contrary to the national interest.

arrangement. However, it is understood that the regulations in force under other laws also cover the various forms of export restriction. 286/

315. In Argentina, an export prohibition is allowed only in respect of markets in which the licensor produces the goods licensed either on a direct exclusive basis or under a licensing arrangement (Decision No. 119, 2(1)). This principle is generally applied by the other countries also. In Brazil, INPI requires in such cases a sworn declaration by the licensee that there exist no other exclusive licenses which preclude exports. 287/

316. The laws of Mexico and the Andean Group allow some flexibility in the application of this clause: in Mexico, the prohibition of exports in a manner contrary to the national interest is interpreted as referring to the total prohibition of exports; to the obligation to export to certain areas where the licensor has not granted exclusive licenses to other enterprises, to limitations of the volume of exports, to the obligation to pay higher royalties on export sales and to the obligation to export exclusively through the licensor. 288/ Within these limitations, partial restrictions on exports may be allowed in appropriate cases. Under Decision No. 24, export restrictions may be allowed in exceptional cases which are duly justified by the competent authority, but they are not allowed in respect of subregional trade or the export of similar products to third countries (art.20, in fine) or in the case of products manufactured under a trade mark, in which case no exceptions are allowed (art.25(a)).

317. It is worth noting that, in Brazil, the competent authority has used legal prohibition as an instrument for negotiating more favourable positions for domestic enterprises: in some instances, such clauses have been allowed for the purpose of securing, in exchange, exclusive use of the license in a larger market (throughout Latin America for example) or to enable the licensee to sub-license or manufacture in other countries.

(b) Tie-in clauses

318. The characteristic of this type of clause is that it requires the licensor or the licensee to do something which, although not necessarily connected with the object of the contract, may entail an additional financial or administrative cost for the receipt of the technology. Restrictive tie-ins may have to do with supplies of raw materials, capital goods, intermediate products, etc; sales of or distribution machinery for the products which are the subject of the license; access to technological developments by the licensee; or the use of other technologies.

286/ For the various forms which this type of restrictive clause may take, see UNCTAD, Restrictive business practices, op.cit. An example of their possible scope in practice is the Brazilian policy of prohibiting the compulsory use of trade marks, with a view to preventing denial of their use in specific territories.

287/ A similar declaration is required when the prohibition is based on legal restrictions of the country of origin with regard to exports to socialist countries.

288/ See E. Aguilar, op.cit., pp.26-27. The information on the control of restrictive clauses in Mexico is based essentially on this work and on the study by J. Alvarez Soberaniz, "Aspectos Legales del proceso de transferencia de tecnologia en México" in Derecho de la Integración, Vol.VI, No.14, November 1973, p.354.

319. Clauses which impose an obligation to purchase equipment or raw materials from a given source are prohibited absolutely in Argentina and Brazil, even if there is a guarantee of favourable prices for the goods purchased. In Mexico, such clauses are not allowed if the goods can be purchased on more favourable terms elsewhere; in some cases it has been laid down that such purchases may be mandatory only when the prices correspond to world market prices. This is the principle adopted in Decision No. 24 and generally applied by the competent authorities in Chile, Colombia and Peru, although in all three countries there have been difficulties in verifying the "international" nature of the prices of the goods imported.

320. The obligation to sell to the licensor or to use his distribution channels is implicitly prohibited by law in Argentina and Brazil, and explicitly by the law of Mexico and by Decision No. 24. In the case of the Andean Group there is an absolute prohibition of stipulations conferring on the licensor a total or partial option to purchase (art.20(e)). In practice, however, some of the member countries have authorized contracts granting the licensor exclusive sales or distribution rights. In Mexico, on the other hand, the policy of the competent authority is not to allow a clause obliging the licensee to sell exclusively to the licensor his entire production at a price established by the licensor, or to sell even part of his production to the latter on unfavourable terms.

321. Clauses whereby the licensee undertakes unilaterally to grant back to the licensor any inventions or improvements obtained through use of the technology transferred are prohibited absolutely under all four legal systems. However, the Brazilian and Mexican authorities have allowed such clauses where they provide for reciprocal and equal conditions on both parties. In Brazil, the reciprocity requirement may be eased if the licence is to be exclusive, although the licensor is generally not permitted to sub-license the licensee's concessions.

322. Clauses which restrict the use of other technologies are absolutely prohibited under Decision No. 24 and prohibited as a rule in Mexico, while in Argentina the decision will depend on the circumstances. The Andean Group's regulation refers to "competing technologies", whereas the Mexican text mentions "complementary technologies". The Mexican Registry has interpreted the provision as meaning that a contract may be denied approval if it prohibits access to other technologies which might enable the licensee to improve the quality of his products or reduce their costs, or if it prevents the manufacture of products which would help to expand or are complementary to the range of products produced. The policy of the Brazilian authorities is sometimes to allow this type of clause, provided that exclusive licenses are involved and that the prohibition applies only for the duration of the contract.

(c) Quantitative restrictions

323. Dictation of the sale or resale prices for the licensee's production is the subject of an absolute prohibition in Argentina and the Andean Group. Under the Mexican law, the fixing of prices may be prohibited by the competent authority if the technology is not of special interest to Mexico. In Brazil, INPI has powers which enable it to control the use of such clauses.

324. Clauses limiting the volume of the licensee's production or sales and may have effects similar to those of other restrictive clauses such as price-fixing or prohibition of exports. Such restrictions are prohibited in Argentina, Mexico and the Andean Group.

(d) Restrictions having effect beyond the duration of the contract

325. As a general rule, the laws of all the countries considered prohibit the extension of patent licensing contracts beyond the duration of the privilege which forms the subject of the agreement. However, this rule does not necessarily cover some stipulations whereby restrictions may be imposed on the use of the matter licensed after the termination of the contract.

326. The laws analysed contain no provision on this subject. This legal lacuna raises no serious problems in the countries of the Andean Group, where the competent authorities may not authorize other restrictive clauses "of equivalent effect" (Decision No. 24, art.20(h)). In Argentina, the legal basis of the control which the competent authority in practice exercises over such clauses is the rule prohibiting the "control or manipulation of the ... production, distribution," etc., of the licensee (art.3(d)).

327. In Brazil, the policy of INPI has so far been to oppose any limitations on the use of the subject-matter of a contract, once the latter has expired. 289/ Clauses concerning secrecy or confidentiality have as a rule been allowed solely for the duration of the contract.

328. In Mexico, clauses restricting the use of technology have generally been denied approval in pursuance of article 7 (II) of the law: in other cases paragraph XI of the article has been involved, which prohibits any limitation of the volume of production. The law has also been interpreted to mean that obligations of confidentiality may violate the legal rule concerning the duration of contracts (sub-paragraph XIII) if such clauses exceed the duration of the licensing agreement.

(e) Extension of jurisdiction or applicability of foreign law

329. The legal régimes of Argentina, Mexico and the Andean Group prohibit entirely clauses whereby the licensor designates or reserves the right to designate foreign courts to hear any disputes which may arise from the contract. 290/ Only Mexico expressly prohibits the application of foreign law for the settlement of disputes. In the other countries, the applicability of foreign law may as a rule be stipulated under general rules of contracting, though the competent authorities may use their general powers to prevent the insertion of such clauses.

C. Administration of the control of agreements

330. Compared to the system for the control of foreign investment the system for the control of agreements has, in almost all the countries concerned, a greater concentration of governmental machinery and functions and methods.

289/ INPI has even prohibited any indirect restriction which might arise from the obligation to return plans, drawings or instructions.

290/ In Mexico, however, as a result of the ratification of the 1971 International Convention on the Recognition and Enforcement of Foreign Arbitral Awards, clauses providing from undertaking as to arbitration are allowed.

1. Institutional arrangements

331. There are, however, considerable differences in the institutional arrangements of the various systems of national control. The systems used in the various countries may be classified as follows:

332. (a) In Argentina and Mexico, agencies have been established on a permanent basis for the specific and sole purpose of controlling contracts on the transfer of technology. One characteristic which is common to both systems and is particularly marked in the case of Mexico, is the importance attached to the legal and procedural aspects of the control machinery in connexion with the bargaining power of the State.

333. In Argentina the competent agency is the National Registry of Licensing Agreements and Agreements on the Transfer of Technology, which comes under the Ministry of Industry and Mines and operates as part of the National Institute of Industrial Technology (INTI). This Institute operates the machinery for the registration of contracts, processes applications for registration and examines and evaluates contracts from a technical, economic and legal standpoint. A report by INTI, containing the results of the general consideration of each application, must be submitted to an advisory committee. 291/ The Committee, in turn, must take a decision on each case and transmit its recommendation to the Ministry, which takes the final decision. The procedure provides for automatic registration of contracts when no decision is taken by the competent authority within a specified period and gives applicants the right to request the reversal of negative decisions taken by the Advisory Committee and also to institute a legal appeal against Ministerial decisions. 292/

334. In Mexico the competent authority is the National Registry for the Transfer of Technology, which comes under the Department of Industry and Trade. The National Registry has two sub-divisions, an evaluation office and a registration office, 293/ as well as an advisory body, the National Council of Science and Technology. 294/ As in Argentina, contracts are registered if the Department of Industry has made no ruling within a specified period. There is also a procedure for review of negative decisions and, unlike in Argentina, this procedure has frequently been used. Thus, there have been about 150 appeals, representing almost 60 per cent of the total number of negative decisions taken by the Registry from February 1973 to March 1974. Moreover, final decisions have in some cases given rise to injunctions by the ordinary courts.

291/ The Committee is composed of representatives of the competent authority, the Science and Technology Branch, INTI, the National Development Bank and the Central Bank (Decree No. 6187/71, article 40).

292/ In practice, decisions to approve or deny approval of agreements have so far been taken on the basis of INTI's opinions and the above-mentioned appeal procedure has hardly ever been used. Thus, although it is a relatively elaborate system, the registration machinery has been able to operate sufficiently smoothly.

293/ See "Funciones de la Dirección General del Registro Nacional de Transferencia de Tecnología, in Derecho de la Integración, No.14, pp.357-360.

294/ In practice, the guidelines to be followed in regard to registration are established at periodical meetings of a Technical Advisory Committee, composed of representatives of the Directorate of Industrial Property, CONYICIT, the Directorate of Industry, advisers from the Industry Branch and the principal officials of the Registry.

335. (b) In Brazil and Peru, the control of agreements on the transfer of technology has been assigned to already existing agencies, which are responsible for the implementation of policies and legislation relating to industrial property. In both countries, the control procedure applies to all licensing agreements, including those concluded between national entities, although specific policies in regard to international agreements have been developed.

336. In Brazil, the competent agency is the National Institute of Industrial Property (INPI), an independent body connected with the Ministry of Industry and Trade through the Department of Industrial Technology. INPI's statutes require it to take measures to accelerate and regulate the transfer of science and technology and establish better conditions for negotiation and use of patents. 295/ As part of INPI, the Secretariat of Information and Transfer of Technology is specifically entrusted with the control of licensing agreements and is responsible for receiving applications, examining, evaluating and negotiating contracts, as well as deciding whether their registration is to be allowed or denied. Applicants may appeal negative decisions to the President of the Institute and, in the last resort, to the courts. There have so far been no cases of legal appeals.

337. In Peru, until mid-1974, the same functions were performed by the Industrial Property and Registry Office of the Ministry of Industry, which was responsible for granting authorizations for all licensing agreements concluded in Peru and for the evaluation and registration procedures provided for in Decision No. 24 of the Andean Group with respect to the international transfer of technology. 296/ The procedure followed in Peru does not provide for the possibility of legal recourse and appeals against decisions of the administrative authority.

338. (c) In Chile and Colombia, the main responsibility for the control of licensing agreements was given to special machinery, which takes the form of committees or working groups within bodies at the ministerial level.

339. In Chile, the commission for the review of royalty agreements, set up in 1967 as an advisory body of the Central Bank and composed of representatives of the Bank, the Production Development Corporation, the Department of Industry and Trade, the Ministry of Economic Affairs and the National Internal Revenue Service, was, until March 1974, responsible for the evaluation and registration of agreements. The Commission was dissolved that month because of the reorganization of the Central Bank, which retained responsibility for controlling licensing agreements, although it limited such control to intervention by a committee composed of the Controller of Foreign Exchange and an adviser from the Executive Committee of the Bank. 297/

295/ Decree No. 68,104 of January 1971 establishing regulations under Law No. 5,648 of December 1970, article 3.

296/ General Industrial Law of 1971, Regulation, article 51 *et seq.*; Supreme Decree No. 001-71-IC-DS/71, articles 51 and 52; Legislative Decree No.18,999 article 2(d).

297/ The Government's supervisory role then declined, pending the appointment, scheduled for mid-1974, of a permanent competent agency, in accordance with the provisions of the Andean Common Régime.

340. In Colombia, the control of licensing agreements has been carried out since 1967 by a committee composed of representatives of the Ministry of Development, the State Planning Department, the Foreign Trade Control Board, the Controller of Foreign Exchange and the head of the Foreign Exchange Office. A Committee on Royalties functions within the framework of the Ministry of Development's Industry and Trade Control Board. As in the case of Chile, no formal procedural rules have been established. Applications for approval of agreements are submitted to the Technical Secretariat, which prepares an initial technical, legal and economic report on the basis of which the committee, usually at one of its weekly meetings, decides to grant or deny approval.

341. (d) Under the Andean Group's Common Régime, as was mentioned earlier, control of agreements on the transfer of technology is closely linked with the control of foreign investment. Thus, the objective reflected in Decision No. 24 is to unify or closely associate the two types of control (article 6). The only member country to have taken such action, however, is Venezuela, where Decree No. 62, issued in April 1974, gives the foreign investment control authority which is part of the Ministry of Development, the task of approving and registering contracts (articles 9 and 58). Contrary to the procedure followed in other Latin American systems, applications are considered denied if the competent authority has rendered no decision within a specified time. In this case, or if the decision is negative, the applicant may appeal to the control authority and, in the last resort, to the Ministry of Development. No provision is made for recourse to the courts.

2. Operation of the system of control

342. The agencies referred to in the preceding section carry out all the most important tasks connected with the control of international licensing agreements. The control is based mainly on the existing power of granting or denying the registration of contracts. Except in Chile and Colombia, where the administrative machinery had already been in operation for some time, the new competent agencies (e.g. in Argentina, Mexico and Peru) have had a great deal to do in the last few years, as the legislation also makes them responsible for the evaluation and registration of contracts already in force.

343. Unfortunately, the statistical data available at the time of completion of the present study are not comprehensive.

344. In Argentina, the Registry received applications for the registration of approximately 1,700 contracts before the entry into force of the law, in addition to requests for some 140 new contracts in 1973. Previous contracts had to satisfy certain material conditions, particularly with regard to restrictive clauses and royalty payments. 298/

345. In Brazil, INPI received approximately 1,200 applications for the registration of contracts in 1972 and about 1,700 in 1973. In 1972, about 1,000 requests were approved and some 50 were rejected. In 1973, there were approximately 1,300 requests approved and 300 rejected. 299/

298/ Decision No.119 of the Secretariat of State for Industrial Development, the main aspects of which have already been dealt with in this chapter.

299/ INPI, reports, 1970-1973.

346. In Colombia, from the second half of 1967 to June 1971, the Committee on Royalties received 395 requests. Of these, 334 were approved and 61 rejected. 300/ In 1973, the committee approved 82 contracts, 40 additions and 55 extensions and rejected 35 requests for registration and 7 requests for extension.

347. In Chile, 1,215 requests had been received by February 1974, of which 530 were approved and 587 rejected. 301/

348. In Mexico, 5,538 contracts dating from before the Law had been submitted to the Registry by March 1974; 1,426 of these contracts were submitted for registration and the rest for information only. The Registry amended 857 contracts, gave a favourable ruling in 62.4 per cent of the cases and an unfavourable ruling, in first instance, in the other 37.6 per cent. 302/

349. In Peru, about 1,200 contracts dating from before the entry into force of Decision No.24 were submitted to the competent authority. By March 1974, about 800 agreements had been examined and registered.

350. The above figures do not, however, provide an adequate explanation of the manner in which the control systems actually operate because, in most cases, the number of contracts approved is simply the outcome of a process of action and reaction by the contracting parties and the authorities during which the original nature of the agreements may change substantially. Moreover, the fact that a contract is rejected does not mean that it cannot be submitted again on a different basis.

351. The operation of the control systems must therefore be interpreted in the light of the exercise of certain responsibilities of the competent authorities, activity which cannot be expressed in quantitative terms. The main function in question is that of negotiation of the terms of agreements, a function which, to a greater or lesser extent, all the national authorities perform.

(a) Bargaining power

352. The concentration of broad powers of control in specialized bodies has, in some cases, led to a significant increase in bargaining power *vis-à-vis* foreign suppliers of technology. The existence of such bargaining power shows how the transfer of technology is viewed as a series of commercial transactions and it is evident in the form of procedure and administration applicable under all the national systems.

353. This feature is present even in those cases where the legal framework of the transfer of technology leaves the competent authority less freedom of action or where there are more procedural rules, as in Argentina and Mexico. In the latter country, many contracts which are denied approval by the Registry are then revised and amended by the parties. Up to April 1974, about 20 per cent of the total number of contracts

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300/ See "Policies relating to technology of the countries of the Andean Pact: their foundations", *op.cit.*, p.20.

301/ Central Bank of Chile, "Reconciliación de contratos de regalías", February 1974.

302/ Enrique Aguilar, *op.cit.*, page 31. This report describes the types of breaches of the law which led to negative decisions by the Registry.

on which a decision had been taken had been modified through a continuing process of negotiation between the Registry and the applicants and through the possibilities of review and appeal provided for in the Law. In Argentina, the negotiation process takes place during the exercise by the Registry of the function of consultation and collection of information entrusted to it by the law. 303/

354. However, the greatest increase in bargaining power has probably taken place in those systems where the competent authority is more independent and less bound by legal rules. The most important examples are provided by INPI in Brazil and the Committee on Royalties in Colombia.

355. The objective of the measures taken by the National Institute of Industrial Property (INPI) in Brazil has been "to establish flexible, gradual and pragmatic control over the transfer of technology". 304/ Accordingly, and on the basis of a set of guidelines concerning the national objectives to be achieved through incorporation of foreign technology, INPI, within its field of competence, has thus far been operating as a genuine marketing enterprise. In this way it has been able to extend the area of control specified in the Industrial Property Code to all categories of transfer of technology and to types of restrictive practices other than those referred to in the Code. In practice, it has also been able to introduce some flexibility in certain of the substantive rules contained in the basic legislation. This has been seen in the earlier consideration of the policy of control of restrictive clauses. For example, some clauses which are usually non-negotiable, such as the obligation to allow the supplier to market the product, or the retrocession clause, are usually allowed in exchange for other "restrictive" clauses favouring the licensee, such as the concession of exclusivity in various countries. Other interesting examples of this type of transaction are to be found in the case of technology which is of little interest to the country but which allowed entry in exchange for an agreement by the company supplying the technology to grant research contracts to local technological research centres.

356. The success achieved by the Committee on Royalties in Colombia, particularly during its first few years of activity, 305/ was largely due to its flexible composition and informal procedures. The membership of the Committee has made it possible for contracts to be analysed on the basis of information from sectors responsible for the control of foreign investment, industrial property, imports and exports and foreign exchange transactions. The Committee usually appoints negotiators to discuss the agreements with the contracting parties, and, in this way, establish the official position. At the same time, it serves as an information centre for Colombian businessmen, so that they may make use, in negotiating, of the information it can provide. 306/

303/ Law No. 19.231, articles 15 and 18.

304/ See INPI, report, 1970-1973, Introduction.

305/ See the above-mentioned study by the Board of the Cartagena Agreement.

306/ See G. Oxman and F. Sagasti, "La transferencia de tecnología hacia los paises del Grupo Andino", OAS, AC/PE-46, April 1972.

(b) Supervision of contracts

357. One of the most difficult problems is supervising the implementation of contracts after they have been approved by governmental agencies. In some countries, special systems have been established for permanent supervision.

358. In Argentina, the registering parties must submit annually to the Registry information in the form of a sworn statement indicating whether the instrument registered has begun to be implemented in the country and accompanied by a form which enables an overall analysis of the contract to be made. The submission of such information is necessary in order to obtain the "Annual Certificate of Registration", the document which furnishes to the foreign exchange and tax authorities proof of the registration of the contract. 307/

359. In Venezuela, the foreign investment control authority may, at any time, check on the performance of contracts, as approved, and, for this purpose, may request and obtain from the contracting parties information on activities carried out under the contracts, and, in particular, on the actual utilization of the technology transferred. The control authority may suspend or cancel the registration of contracts if it finds any non-observance of their terms. 308/ Similar provisions are contained in Mexican law, which provides that the Department of Industry and Trade may, at any time, verify compliance with the provisions of the law and cancel the registration of contracts which are changed or altered in any way contrary to what was agreed at the time of the registration. 309/

360. In other countries of the region, where the power of control is not expressly established in the legislation stated in legal provisions or in the definition of administrative responsibilities, the method followed by the competent authorities, particularly in Brazil, Colombia and Peru, is to impose short initial periods of validity for contracts in order to be able to review their implementation before renewing them.

3. Some problems of co-ordination

361. This description of the organization of control procedures by the different countries shows that there are considerable differences in the administrative positions of the competent authorities. Thus, in some countries, such as Argentina, the competent authorities are directly linked with the governmental bodies responsible for

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307/ The information provided by the contracting parties relates to the structure and composition of the local enterprise and of the foreign contracting party, the financial relationship between the two enterprises, the arrangements for receipt of the technology and any changes in the licence during the term of the agreement, information on the various inputs received, the extent to which they are used, payments made for all purposes, the value of items purchased from the licensor, sales and exports, research and development expenditure, etc. Decree No. 6187, article 21. Registro Nacional de Contratos de licensias y Transferencia de Tecnología, "Declaración Jurada Annual para el periódo del 1.1.75 al 31.12.73".

308/ Decree No. 62 of April 1974, article 60.

309/ Law on the Transfer of Technology, articles 11 and 12.

planning and technological development. Other countries (e.g. Brazil) have preferred to disassociate the control machinery from the sector responsible for the development of technology, in order to give it greater autonomy with regard to the commercial and negotiation aspects of the transfer process.

362. It is difficult to assess the relative advantages of such organizational possibilities because they almost always depend on the structure of the public administration of the country in question. It is also necessary to point out, at least in general terms, that the implementation of the control system gives rise, to a greater or lesser extent, to problems in all the countries.

363. In some cases, the most serious difficulties seem to be caused by problems of co-ordination with other bodies in areas of joint competence. An example of this type of difficulty, to which reference has already been made, is the overlapping of functions with regard to the selection of technology; such overlapping may occur between specialized bodies and those responsible for granting industrial development incentives. In Brazil, if the Industrial Development Council has been involved in the control of contracts, INPI's activities may be limited exclusively to control of their financial aspects and the Institute thus plays no role in deciding on the categories and types of technology to be imported. A similar case may arise in Colombia, where the approval of contracts relating to technical services has thus far been outside the competence of the Committee on Royalties. [310] There are, however, some significant examples of efforts to ensure effective co-ordination between various bodies, as in Decision No.199 of the Argentine Ministry of Industry and Mines, which provides that customs licences for the import of capital goods may be granted only after the Registry of Technology has approved, where appropriate, contracts that impose an obligation to engage foreign personnel for the commissioning or installation of the equipment or goods; or as in the provisions of the Mexican law, which entrusts the control of payment of royalties to industrial development agencies and also to other governmental authorities, such as the Income Tax Branch of the Ministry of Finance. [311]

364. The most serious aspect of the problems referred to is probably the separation between the control of foreign investment and the control of agreements on the transfer of technology. Except in the recent Venezuelan law, which combines the two types of control, and in the case of the Colombian Committee on Royalties, whose composition seems to ensure adequate co-ordination, these functions are decentralized in separate and unrelated bodies. Although the legal provisions applicable in each case do not as a rule conflict, the division of roles may give rise to different policy approaches depending on whether the transfer of technology takes place through foreign investment or channels of a contractual nature. Moreover, some important matters may remain in a "grey" zone and receive no adequate solution. Such matters include the capitalization of technology (directly or through the conversion of royalties into shares) and the payment of royalties by the subsidiary to the parent company.

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[310] Article 101 of Decree No.444 gives responsibility for approval of such contracts to the Foreign Exchange Office.

[311] The activities of both bodies with regard to the granting of incentives and tax deductions, respectively, are intended to compensate for the lack of foreign exchange controls.

Chapter VI

CONTROL OF TRANSNATIONAL CORPORATIONS

365. Transnational corporations may be viewed as constituting an unwanted challenge to governments' power of decision with regard to the methods and objectives of national economic policy. What distinguishes this problem from other aspects of development is the fact that multinational enterprises are fully-fledged protagonists in the international system alongside nation States, with a comparable capacity to wield power in economic and social relations, plan their long-term objectives and regulate the use and distribution of productive resources. The organization and procedures of transnational enterprises thus tend to be similar to those of political systems, although with two important differences: the rationals for their conduct lies in growth patterns and the maximization of profits, two aims which do not necessarily coincide with the broader objectives of nation States, and the exercise of their power is not legitimized or regulated by the international community.

366. The root of the difficulty in controlling transnational enterprises lies in the dichotomy between their transnational character and the national character of the sovereign States into which the world is divided. Because of their flexible forms of organization, these enterprises have been able to devise methods for the global planning of their business which enable them to use and control resources situated in different countries by operating "above" the jurisdictions to which such resources officially belong and in accordance with a common strategy in which State policies are merely "external factors" to an integrated decision-making system. From the legal and institutional point of view, transnational enterprises can be regarded as a number of companies separately incorporated in different States and acting simultaneously under different laws and jurisdictions. The legal foundation of these enterprises is thus divided into as many parts as there are countries where they are established. Their organizational structure, the taxes which they must pay, their transfers of resources from one country to another and the sectors in which they may operate are theoretically subject to the rules laid down by each nation State. However, because of the economic and administrative unity of the transnational enterprise, the legal labyrinth in which it operates appears to place it in "no man's land" as far as exercising control over it is concerned.

367. Thus, much of the problem in controlling transnational enterprises is to ensure that it is not they, through their transnational flexibility and the juggling of alternatives not available to Governments, which control certain crucial aspects of national economic policy. By carrying on their activities as part of a global operation, transnational enterprises may side-step national policies, render them ineffective and also, to some extent, determine their content. Thus, matters such as the generation and distribution of income between countries or within a particular country, the supply of foreign exchange, the fixing of levels of industrial protection and prices, tax collection and even qualitative factors such as consumption patterns may, to a greater or lesser degree, tend to lie to a great extent, beyond the effective control of Government authorities.

368. Until quite recently, the problem of transnational enterprises had given rise, in Latin America only to academic discussion and political statements. Moreover, Latin America, like other parts of the world, is not yet sufficiently clear about the very definition of the transnational enterprise, and even less about its over-all effects on the national development process. In most countries of the region, however, the phenomenon of transnational enterprises has begun to emerge as a specific problem, not only at the level of general economic policy but also through administrative machinery and decisions and even within the context of traditional legal entities, where the emergence of such enterprises has challenged the validity of "sacred" legal principles such as legal personality, the nationality of companies, etc.

369. Many of the measures taken by the Latin American countries with regard to transnational enterprises are implicit in the new regulations made on the subject of foreign investment and the transfer of technology. As has already been mentioned, the new approaches adopted are essentially a response by States to the presence and operational impact of transnational enterprises in their territory. Some aspects of these régimes can be explained only in terms of transnational enterprises, although they do not relate explicitly and exclusively to the latter. Among the most obvious examples of this tendency is the concept of control régimes as negotiating systems, the establishment of mixed enterprises, the regulation of royalty payments abroad according to the enterprise's capital structure and the control of restrictive clauses in licensing agreements. In all these areas, the phenomenon which it is sought to control is obviously not merely the international transfer of productive resources as such, but the decision-making system from which they originate and on which the respective transfer processes depend.

370. The realization that the transnational enterprise phenomenon goes beyond the area of foreign investment and the transfer of technology is apparent in a series of measures taken in other fields of government economic policy. It is interesting to note in this connexion that such enterprises have often been explicitly referred to in traditional fields of law such as company and tax legislation and in technical regulations such as external trade and industrial development régimes.

371. The measures which have been adopted by the various countries are based implicitly on a distinction similar to that drawn between national and foreign enterprises. In this case, the distinction takes into account the fact that transnational corporations constitute a special type of foreign enterprise with which not all the instruments of action based on the former distinction are sufficient or adequate to deal.

372. For the purposes of the present study, it is pertinent to emphasize the existence of some kinds of restrictive practices which are directly linked with the transnational character of particular enterprises - in other words, with certain special aspects of their organization and functioning which are not attributable to the fact that their capital is foreign in origin or that their decision-making centre is situated in a highly industrialized country. We propose to examine below some measures taken by Latin American Governments to control two types of restrictive practices which have been recognized as being among the most important: price-fixing in respect of goods and services exchanged between the enterprise and its affiliates in different countries, and the allocation of production and export markets between the various territorial units of the transnational enterprise.[312]

A. Control of transfer pricing

373. The transfer prices applied to transactions between firms belonging to a single transnational group affect the international distribution of the profits from the group's activities. The decisions of transnational enterprises in this area are based on a global assessment, the criteria for which must include the need "to maximize profits and appreciably minimize taxes; and to place profits where they can be used to the best advantage".[313] For these purposes, transnational enterprises have various

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[312] See the report of the Group of Experts already referred to (UNCTAD document TD/B/C.2/119) and Economic and Social Council, The Impact of Multinational Corpporations, op.cit.

[313] See Business International, "Setting intercorporate pricing policies", Business International Research Report, New York, 1973, p.12.

channels and mechanisms for transferring income from one country to another. It is well known that, in addition to remittance of dividends, there are other methods which may be used such as over-payments for imports from the parent company or other affiliates, under-payments for exports to these companies, the charging of royalties and payments for services, commissions, interest charges etc.[314]

374. It is extremely difficult to exercise control over the pricing policies of multinational enterprises since there are no precise methodological guidelines for determining fair prices or actual levels of income. Secrecy in such matters is of vital importance to these enterprises. Moreover, the specific forms which such policies take depend on a number of internal factors related to theover-all strategy of the transnational company in question and on a number of external factors among which the various government policies in the countries where the company has affiliates play a primary role. The latter point is especially important, since the differences in national policies, as between countries and within individual countries, may affect the outcome of the price manipulation for every country involved. For instance, the higher a country's rate of corporate profits tax, the greater will be the tendency to scale down apparent profits, either by raising the prices charged to the affiliate or by lowering the price at which the latter sells to other affiliates.[315]

375. Most of the Latin American countries make fairly extensive use of policy instruments which can indirectly stimulate decisions on the area of transfer pricing. As has been seen elsewhere in this study, almost all these countries have foreign exchange and import controls, tax incentives, price controls, rules requiring the formation of mixed enterprises, etc. At the same time, as will be seen in greater detail below, it is also common for differences to exist within each country as regards the foreign exchange and tax treatment to enterprises and therefore sufficient factors seem to exist to encourage the very active use of various methods for the international transfer of profits from local affiliates of transnational enterprises. Moreover, several studies show that in a number of these countries, fairly frequent use has been made of the transfer pricing mechanism which has had adverse overall effects on the foreign exchange and taxation policies of the Latin American countries concerned. One of the most fully documented practices is the over-invoicing of raw materials, capital goods and inputs imported from the parent company or from other affiliates abroad,[316] a procedure which is usually accompanied by "tie-in clauses" in international licensing agreements. There is also evidence to indicate that remittances of royalties

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[314] For a detailed analysis of this subject, see D. Zenoff and I. Zwick, *International Financial Management*, N. Terey, 1969, chaps. 12 and 13; M. Brooke and H. Lee Remmers, *The Strategy of Multinational Enterprise*, New York, 1970, pp. 172 *et seq*.; S. Robbins and R. Stobaugh, *Money in the Multinational Enterprise*, New York, 1972, chap. 10; and C. Vaitsos, *Intercompany Income Distribution and Transnational Corporations*, *op.cit*.

[315] See Economic and Social Council, *The Impact of Multinational Corporations*, *op.cit*., p.74

[316] For Colombia, see C. Vaitsos, *Transfer of Resources and Preservation of Monopoly Rents*, Economic Development Report No. 168, Harvard University, 1970; for Chile, see CORFO, *Costos inplícitos en la transferencia de tecnología*, 1971; for Mexico, see M. Wionczek *et al*., *La transferencia de tecnología a nivel de empresa*: *el caso de México*, *op.cit*.; for Argentina, see A. Araoz, M. Kamentzky and O. Bourquin, *Estudio sobre el comercio de tecnología*, 1971.

and interest payments have been used as devices to complement or replace dividend remittances, in order to avoid or reduce the impact of national foreign exchange controls and taxation.[317]

376. Some countries of the region have begun to resort to special measures in order to control these types of restrictive practices.

1. Control of the over-invoicing of imports and other practices connected with external trade

(a) Direct control methods

377. In Argentina, the Foreign Investment Law established a system for controlling the entry of capital goods as capital investment.[318] These specific provisions are supplemented by other, more far-reaching procedures designed primarily to prevent fiscal misrepresentation.

378. In late 1972, the Customs Law was revised in order to make it easier for the Administration to suppress customs offences - including the over-valuation of imports, a practice not previously dealt with because "the Customs authorities generally focus their efforts on detecting phenomena of the very opposite kind".[319] Under the law,

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[317] See C. Vaitsos, Income Distribution, Welfare Considerations and Transnational Enterprises, op.cit.; F. Fajnzylber, "La empresa internacional en la industrialización de América Latina", Comercio Exterior, op.cit.; E. Cimillo et al., Acumulación y centralización del capital en la industria argentina, op.cit.

[318] The Argentine law requires that capital goods shall be new, shall be representative of the most modern technology and shall be required for the establishment of the plant; investors must also produce accountants' certificates of the goods' value in the country of origin, showing that their price in the manufacturer's books matches that given on the invoice for investment.

[319] Law No. 19,881 of 11 October 1972. The preamble to this Law states that "the situations which are most susceptible to such practices are those in which the direct customs duty costs arising from the additional duty payable because of over-invoicing is insufficient to offset the unlawful advantages which may be derived from the difference between official and unofficial foreign exchange rates, the total or partial evasion of anti-dumping or countervailing duties and the evasion of direct internal taxation through the artificial inflation of costs with a corresponding decrease in profits", practices which are particularly prevalent in the case of import duty waivers or exemptions, imports subject to reduced rates of duty, official minimum prices and improper utilization of tariff preferences. Moreover, "such over-invoicing has the additional effect of completely distorting the machinery for evaluating other transactions since data derived from goods imported free of duty or at a reduced rate of duty may provide a basis for valuing identical or similar goods not benefiting from such treatment; moreover, if it was decided to levy or increase duty on goods previously exempt from duty or subject to a low rate of duty, such data would be the only information available. In other words, quite apart from the direct damage inflicted on the country's foreign exchange machinery at a particular point in time, direct harm is also done to the tax system as regards anti-dumping and countervailing duties and indirect harm as regards other duties".

false declarations of the value of imported goods are punishable by a fine and the imports in question are prohibited in the event that such declarations might result in the improper transfer of foreign exchange abroad or entail any infringement of the foreign exchange, monetary, credit or tax regulations. Moreover, a law regulating customs duties and procedures [320] defined the customs value of imported goods intended for consumption as "the normal price, namely, the price which it is estimated can be established for such goods at the point in time which, under the Law, determines the import duties payable as a result of a sale effected under conditions of free competition between a buyer and a seller who are independent from one another." [321]

379. Furthermore, in late 1973, the Tax Offences Division of the General Directorate of Taxation launched an investigation of the major firms in Argentina with the aim of detecting any possible evasion of tax obligations by means of different payments or remittances of funds abroad. To that end, the Directorate addressed to enterprises various requests for information concerning, inter alia, purchases of imported raw materials and acquisitions of fixed assets during the preceding five years. The request for information contains a long list of particulars that must be accompanied by appropriate supporting documents. [322] The Profits Tax Law contains a provision to the effect that, when the invoice price of the imported goods exceeds the wholesale

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[320] Law No. 18,990 of 13 October 1972.

[321] Art.3. Art.4(g) of the same law defines a "sale effected under conditions of free competition between a buyer and a seller who are independent from one another" as a transaction in which the following conditions are fulfilled:

"(a) Payment of the price of the goods is the only effective contribution made by the buyer; (b) The agreed price is not influenced by such commercial, financial or other ties, whether or not of a contractual nature, as might exist, except for those created by the sale itself, between the seller or any business associate of his, whether an individual or a body corporate on the one hand, and the buyer or any business associate of his, whether an individual or a body corporate, on the other; (c) No part of the proceeds from any subsequent resale, disposal or use of the goods should revert directly or indirectly to the seller or to any business associate of his, whether an individual or a body corporate. Two persons shall be deemed to be business associates when one of them has any kind of interest in the business or goods of the other, or if the two of them have a joint interest in any business or goods, or if a third party has an interest in the business or goods of each of them, whether such interest is direct or indirect."

[322] With regard to imports of raw materials, for example, information is requested on the following matters:

(1) Quantity and type of goods (a description should be given of the goods and the quantity acquired during the appropriate financial year and it should also be indicated whether there exists any possibility of local substitution);(2) description of the consignor (enterprise, domicile and economic and financial links); (3) country of origin of the goods; (4) value of the goods (unit price in foreign currency); (5) rate of exchange used and consequent differential; (6) wholesale price in country of origin; (7) freight, insurance and commission charges; (8) method of financing the purchase; (9) rate of interest; (10) name of vessel in which goods were carried, shipping agent and customs broker involved.

price plus insurance and freight, it is presumed that a linkage or subordinate relationship exists between the foreign exporter and the local importer or that they form an economic unit, and that consequently the goods imported should be assessed at the wholesale price, with a resultant decrease in the costs to the local firm and an increase in its tax liability. The excess amount is then regarded as a profit credited or remitted to the apparent seller.323/

380. Finally, it should be noted that fiscal control of external trade transactions has been extended in Argentina to cover the under-invoicing of exports. In this connexion, the General Directorate of Taxation has requested enterprises to furnish information concerning export credit transactions, including details on credit cards used, banking institutions involved, rates of exchange applied, shipping permits, etc.324/

381. In Brazil, the Foreign Investment Law provides for the control of investment goods on the basis of certification of their price in the country of origin and of the value ascribed to them by the receiving enterprise. Over-invoicing is regarded as a customs or foreign-exchange offence.325/ Direct control of the over-invoicing of imports is the responsibility of the External Trade Section of the Banco de Brasil (CACEX) which examines the world market price of the goods acquired, whether as ordinary imports or for investment in Brazil. In the case of direct investment, CACEX's valuation determines the final value ascribed to the goods in the Register of the Central Bank. The main valuation method applied by the Industrial Division of the Imports Department of CACEX is comparison with the price of other imports of similar goods on which data is available. Moreover, under Brazilian administrative law, the entering of imported goods in an enterprise's accounts at a value higher than that shown in the import licence has been held to be an advance payment of profits.326/

382. Decision No. 24 of the Andean Group provides for control of the valuation of imported goods and equipment intended for investment. Some countries members of the Group have established special control arrangements. In Colombia, Decree No. 444 of 1967 empowered the Office of Foreign Exchange to establish procedures for evaluating external investments of machinery and equipment.327/ Decree No. 1,234 328/ later

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323/ Law No. 11,682, art.9(b). The Supreme Court of Justice of Argentina applied this provision of the law in the Rheinstahl-Hanomag Cura S.A. case on 17 December 1973. A similar provision in article 70 of the same law deals with imports of goods which are to form part of the fixed assets of the local enterprise: in such cases, the resultant difference cannot be amortized or deducted in any way for tax purposes.

324/ This practice is also subject to control under certain provisions of the 1972 Customs law, No. 19,881.

325/ Law No. 4131/62, art.4; Decree No. 55762/65, art.5.

326/ "Board of Taxpayers", Decision No. 56,643.

327/ Decree No. 444, art.113.

328/ Decree No. 1,234 of 18 July 1972, art.9.

provided that the National Institute for External Trade (INCOMEX), acting in co-ordination with the Royalties Committee and the Office of Foreign Exchange, would establish arrangements for obtaining information on and controlling the prices of raw materials and intermediate products furnished by suppliers of technology or foreign capital. Control of the valuation of imported goods is currently exercised by the International Price Control Division of INCOMEX. Since the Institute is responsible for issuing import licenses, control over prices is exercised in a preventive manner when licences are applied for or import requests are processed. Control may also be exercised, in co-ordination with the Banco de la República, once the goods have been imported and before the foreign exchange is transferred abroad. To date, control activities have been confined primarily to inputs for the chemical and pharmaceutical industry.329/

(b) Indirect control methods

383. Whereas measures for direct control of over-invoicing of imports are to be found in only a few countries, there are a variety of indirect control instruments in most of the national systems. Some of the main instruments of this kind are described below.

(i) Control of the value of additions to companies' assets

384. In almost all the countries of the region there are bodies responsible for the external supervision of commercial enterprises and one of the main functions of these bodies is to control the value of material additions to the capital of companies by the shareholders. In several countries the procedure for evaluating such additions is strictly regulated: provision is made for the convening of a special general meeting of the recipient company, appraisal by experts and approval of the evaluation by the company supervision authorities or similar bodies. 330/ Nevertheless, the possibilities

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329/ Other countries also have legal and administrative instruments which would appear to enable some control to be exercised over the prices of imports. For example. the Foreign Exchange Law of Ecuador provides that the Foreign Exchange Department may take steps to verify statements regarding the price of imported goods and even, if necessary, establish maximum or minimum prices, taking into account prevailing prices on the world market (art.9). However, the existence in Ecuador of a free exchange area would appear to diminish the importance of controls over the over-invoicing of imports. Chile also has a body responsible for supervision of import prices - the Prices and Values Department of the Central Bank - but insufficient information is available on the Department's activities in this field.

330/ See, for example, the Commercial Codes of Colombia (art.398) and Chile (art.443), and the Companies Law of Ecuador (art.166) of controlling the over-invoicing of goods imported by this means are generally small, because the resources available to the supervisory bodies for this purpose are limited. In practice, control is based on the value stated in the relevant commercial invoices.[331]

(ii) Price control

385. Domestic price control systems can serve as an important means of controlling the over-invoicing of certain imported goods. The effectiveness of this machinery for this purpose appears to depend on the type of price control exercised and the powers of the competent bodies to investigate the cost structure of domestic production and of any imported inputs. For example, it may be more difficult for enterprises to fix prices for imported inputs when there are mandatory price ceilings for sales ex works or to consumers than when gross margins are established, especially where local subsidiaries have to demonstrate to the tax authorities a certain degree of profitability.

386. In some cases, such as the pharmaceutical product sector, several countries operate special control systems which extend to supervision of imports of raw materials.[332] In other cases, the bodies responsible for implementing industrial development measures may exercise indirect control over the cost structure of enterprises through the establishment of maximum prices for the domestic products of foreign subsidiaries. For example, the Department of Industry and Trade of Mexico, in granting the incentives provided for under the various development schemes, requires of enterprises that the prices of their products, determined on the basis of costs, shall differ as little as possible from the international market prices and that, except when fully justified, they should not exceed by more than 15 or 25 per cent (depending on the particular development programme involved) the prices of the product in the country of origin, in other words, the country from which the machinery, raw materials or major supplies are imported.[333]

(iii) Control of International Licensing Arrangements

387. The two preceding chapters have referred to a number of measures incorporated in the régimes for the control of foreign investment and of restrictive business practices in international licensing arrangements which may prevent transfer pricing that is prejudicial to the recipient countries.

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[331] Because of the special interest of these bodies in the composition of the corporate capital, their control function tends to be directed rather towards instances of the opposite situation, namely, the undervaluing of non-monetary contributions. An interesting exception is the function performed by the companies supervision authority of Ecuador, which includes a separate control of the international movement assets of companies which are subject to control: the information obtained on the value of every category of import is related to the country of origin and nationality of the shareholders and directors of the enterprises concerned (see Decision No. 3,235 of the companies supervision authority of 1 January 1973).

[332] See chapter II, in particular as regards the function of the Interdepartmental Council on Prices (CIP) in Brazil. Also worth noting is the recent establishment in Venezuela of the National Executive Commission for the Supply and Marketing of Inputs and Raw Materials, which is empowered to regulate the prices and the distribution of these goods (Decree No. 71 of 7 May 1974).

[333] See Department of Industry and Trade, "Posibilidades industriales: instrumentos de promoción industrial", op. cit., pp. 9-30.

388. One of the most significant measures, adopted in Argentina and the Andean Group countries, is prohibition of the capitalization of know-how as a foreign investment. This measure is based on reasons of a conceptual nature (the non-justification of payment for an input which involves no additional cost to a transnational enterprise)334/ and also on practical considerations; evaluation of this kind of assets is very difficult 335/ and their investment may give rise to various abuses. The acceptance of capitalization of technical expertise might provide grounds for reduced payments of local taxes (e.g. through deductions for the depreciation of intangible assets) and be used to artificially increase the capital base on which taxable profits are calculated, as well as to evade possible controls on repatriation of capital and remittance of profits.

389. Several of the countries in Latin America tend to restrict lump sum payments for foreign technology inasmuch as such a payment unlike royalty payments, makes it impossible to relate the payment for the know-how to evidence of its effective use by the recipient enterprise. 336/

390. A further purpose of the control instituted under the laws controlling international licensing arrangements is to curb over-invoicing of tied imports. However, in the case of licensing agreements between parent and subsidiary enterprises government controls are difficult to implement since the tie-in clauses need not be formally spelt out. A more efficient method is to calculate the amount of royalties minus the value of the imported inputs. This system is used in some countries, including Argentina and Brazil.

(iv) National integration requirements

391. In several Latin American countries, the general and sectoral industrial development systems impose varying requirements as to the percentage of national value added. These requirements are normally accompanied by machinery for controlling imports, on the basis of systems designed to protect the domestic production of goods "similar" to the imported goods, generally in the raw materials and capital goods sectors. The use of these instruments in countries such as Argentina, Brazil, Chile, Colombia, Mexico and Peru indirectly curtail the freedom of transnational enterprises to manipulate import prices.

(v) State participation in import transactions

392. In several Latin American countries, as has already been observed, State intervention in economic activities has manifested itself in the establishment of decentralized bodies to operate in certain sectors deemed to be of strategic importance. One of the most significant results of this process, which was mentioned in part one of this study, is the emergence of public enterprises that participate in foreign trade operations.

334/ See C. Vaitsos, Transfer of resources and preservation of monopoly rents, op. cit.

335/ See Business International, "Setting intercorporate pricing policies", op. cit., page 62.

336/ The Argentine law on the transfer of technology provides that technology may be paid for by a predetermined lump sum (art.11). However, the competent authority has never allowed this provision to be applied.

393. Reference has already been made to the actual and potential role of organizations such as the National Supply Enterprise of Argentina, the National Supply Supervisory Authority of Brazil, the National Essential Supplies Company of Mexico, and similar bodies in Chile, Colombia and Peru (where the competent agency has the monopoly of industrial imports). Regardless of the scope and future development of enterprises of this type, their capacity to intervene directly in negotiations for the import of goods can made them an appropriate means of preventing the fixing of transfer prices through the operations of the subsidiaries of foreign enterprises. National participation in the import decisions taken by enterprises dependent on foreign firms may also be achieved, to a certain extent through a policy of participation by domestic investors in joint enterprises together with subsidiaries of multinational enterprises.[337]

2. Control of other channels for the remittance of profits abroad

394. There are ways other than through import and export transactions that a transnational enterprise can transfer profits. In the case of payments in respect of technological expertise and loans from the parent enterprise or other subsidiaries to local subsidiaries, the problem lies not only in the possibility of over-valuation (i.e. the payment of artificially high royalties and interest) but in the manner in which foreign payments made through a particular channel or combination of channels may increase the net remittance of profits abroad, with a corresponding prejudicial effect on national income, essentially as regards the country's balance of payments and tax revenue.

(a) Control of royalty payments

395. Tax considerations constitute the main factor in the fixing of prices for licensing contracts which transnational enterprises conclude with their subsidiaries. In other words, they are the main reason for the selection of this medium for the remittance of funds abroad.[338] If royalties are not subject to high rates of tax, the enterprise will generally prefer to maximize the payments made under this heading, instead of through dividend remittances.

396. In Latin America, for reasons peculiar to taxation policy, a situation has arisen in which the payment of royalties usually has relatively clear-cut comparative advantages. The rate of tax levied on royalties is generally lower than that levied on dividends remitted abroad; in addition, the payment of royalties constitutes expenditure which is deductible from the taxable income of the local corporation.[339] Furthermore,

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[337] A number of studies suggest that, although the presence of domestic investors may prove unfavourable to the recipient countries in some aspects of the fixing of transfer prices (for example, in the matter of royalties and payments for services to the parent enterprise) it is, on the other hand, an important factor in controlling the prices of imported goods. See J. Stopford and L. Wells, Managing the Multinational Enterprise, op.cit.

[338] See Business International, Setting intercorporate pricing policies, op.cit., page 58.

[339] In several countries - Argentina, Chile, Ecuador, Peru, Uruguay and Venezuela - percentage deductions from royalty tax are also permitted in respect of the cost of research conducted abroad.

in some countries the tax may vary, depending on whether, for example, the payment involved is a charge for industrial property or for technical assistance services.[340]

397. For many years, given the tax situation described above, the absence in Latin America, of government regulations on international licensing agreements may have led to the marked tendency for foreign enterprises to use such agreements as a means of remitting funds abroad and evading tax. A number of investigations have made it clear that many contracts calling for payment of royalties abroad were bogus and did not involve the performance of services of any kind.[341] In this connexion, it should be noted that one of the first control measures taken was within the context of their taxation laws, namely proof that technology was actually transferred to obtain the deductions allowed by the law.[342]

398. Nevertheless, the investigation by the taxation authorities to determine whether transactions involving technology have actually taken place could be ineffective in the case of enterprises dependent on transnational corporations, because of the flexible manner in which these corporations can co-ordinate their activities and, above all, because of the previously mentioned difficulty of attributing a value to the transfer of technology in these circumstances. The solution chosen by several Latin American countries has been to regulate royalty agreements between subsidiaries and foreign parent companies within the context of a general enactment concerning the treatment of transfers of technology. The remedy found for the particular case of payment of royalties between related enterprises has been, the pure and simple prohibition of this practice. This is the general rule in _Argentina_ and under Decision No. 24 of the _Andean Group_, and also in _Brazil_ with regard to payments in respect of patents and trademarks.[343]

(b) Control of financial relationships

399. The establishment of financial obligations between the parent concern and the subsidiaries may be an appropriate alternative within an overall strategy for the movement of funds from one country to another. The granting of external loans to

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[340] In Ecuador, Paraguay, Peru and Uruguay, the levy varies according to the different categories of technology, a different rate or a rate by category being applied in the system of deductions.

[341] See for example, Dirección General del Impuesto sobre la Renta, "Algunas consideraciones sobre la asistencia técnica", in _Investigación fiscal_, Mexico, Department of Finance and Public Credit, No. 46, October 1969.

[342] See, _inter alia_, _Bolivia_: Legislative Decree No. 11, 154, art. 26; _Brazil_: Law No. 4,131, art.12; _Chile_: Law No. 15,564, art.25; _Mexico_: Income Tax Law art. 20 and 26, I and XII; and Uruguay: Decree No. 34/73, art.5.

[343] Furthermore, royalties are not tax deductible in _Brazil_, the only deductible payments are those for engineering services (performed and paid for in a single sum) (Decree No. 55,762/65, art.20).

subsidiaries may be useful, inter alia, as an initial means of effecting direct foreign investment. Since all the legislations permit the capitalization of external credits, as constituting a form of foreign investment, the possibility of forming part of a subsidiary's financial structure by means of funds in the form of a loan, with the option of later transforming this contractual relationship into participation in ownership, gives the multinational enterprise additional flexibility.[344] Furthermore, although the conclusion of foreign loan agreements must in most countries be authorized in advance, repayment of the principal and payment of interest are generally subject to fewer exchange restrictions than the repatriation of direct investments and the remittance of dividends.

400. The main advantage of external loans as a means of profit remittance lies, just as in the case of royalties, in their tax treatment. Firstly, the repatriation of capital is subject to normal taxation (on capital earnings, the liquidation of the enterprise and the sale of shares) which is not levied on loan repayments. Moreover, the interest on loans is subject to a generally lower rate than are dividends and it is, in addition, deductible by the enterprise concerned for income tax purposes.

401. In order to prevent the abuses in this area, several Latin American countries have recently taken a number of control measures. In Argentina, the external indebtedness of foreign enterprises has been specially regulated in the law on foreign investment. The authorization of such loans must, in all cases, be subject to "the principle of economic reality". In addition, such loans may not exceed the maximum limit of indebtedness established for each transaction by the Central Bank, and the amount of transfers abroad in respect of contractual penalties incurred by the foreign enterprise because of its negligence or fraud is deducted directly from the amount of the repatriable capital.[345] The law also provides that financial contributions between subsidiaries or branches and their parent enterprises or between the former, or between domestic and foreign enterprises between which there exists a "relationship structural of dependency", shall be governed by the legislation on capital contribution or profits.[346] Approval is thus given to a system similar to that governing royalty payments between subsidiaries and parent concerns, namely, the treatment of such payments as dividends.

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[344] This advantage is enhanced by the fact that most of the legislations are not very demanding as regards the minimum amount of capital required for the establishment of corporations. For a description of the manoeuvres by foreign enterprises to which this legal situation has led in Ecuador, see Superintendencia de Compañías, op. cit., pp.37-39.

[345] Law No. 20,557, art.25. In all external loan agreements, the rate of interest charged may not exceed by more than two percentage points the prevailing rate for first-class securities in the financial market of the country of origin (art.36).

[346] Law No. 20,557, art.26. A similar conclusion arises from the Income Tax Law (No. 20,628, art.14), which provides that loans originating in financial inputs furnished by foreign parent enterprises or by enterprises connected with a foreign country shall be non-deductible.

402. It is interesting to note that the highest judicial authority in Argentina recently applied (as it had previously done with regard to payments for technology) the "theory of penetration" to the financial relations of the subsidiaries of multinational enterprises. In this case, the Supreme Court dismissed the claim by Ford Motor Argentina for the reimbursement of the sum of approximately $130,000 paid to the tax authorities as tax in respect of amounts credited by that enterprise to the Ford Motor Company of the United States of America as a supplementary charge for deferred payment on imports. The Court held that the sums paid to the United States enterprise were not in the nature of interest but a payment or remittance of profits of the local enterprise to the foreign company.[347] The principal antecedent of this decision was another judgement of the Supreme Court which, although it goes beyond the problem of transfer pricing, should be mentioned because of the significance of the case and of the whole proceedings for the subsequent development of Argentine jurisprudence. The decision was handed down in a case involving creditors of the meat packing enterprise Swift de la Plata, a subsidiary of the Deltec International Group. In this case, the Court decided to reject the loan verification application brought by other enterprises financially dependent on the multinational enterprise, on the ground that the loan agreements involved were not genuine in that they lacked "the fundamental creditor-debtor relationship which is implicit in any relationship of obligation".[348] Furthermore, when Swift was declared backrupt, it was decided that the effects of the bankruptcy should also apply to Deltec International Limited, as the real debtor and the party responsible for the obligations of the apparent bankrupt company, whose property it owned and controlled, with the result that the seizure of goods was also applied to other local subsidiaries of the Deltec enterprise in Argentina.

403. Decision No. 24 of the Andean Group establishes the requirement of prior authorization for all foreign credit and provides for the possibility of fixing global limits of external indebtedness for specific periods (art.14). In the case of

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[347] Supreme Court of Justice, June 1974. In its judgement, the Court adds that Ford Motor Argentina invoked its character as a juridical person established in Argentina, legally independent and subject exclusively to the laws and authorities of the Argentine Republic. Nevertheless, it notes, the enterprise adopted this position in order to present itself as having the same tax situation as that of a normal purchaser who imports goods which he has bought from a foreign seller. It adds that its judgement in no way affects the fact that the enterprise is subject exclusively to Argentine legislation - and hence not to any foreign Power - since, in the case of a commercial company which is one of several that together constitute a transnational economic complex and thus operate simultaneously in a number of countries, the various branches are subject to the different national laws and jurisdictions of the place where they are established, in accordance with the provisions of article 100 of the National Constitution and article 14 of the Civil Code, which covers in particular situations such as the one in question, in which the public order and institutional interest of the Argentine nation are involved.

[348] Supreme Court, 4 September 1973. The applications for verification of loans by members of the Deltec Group amounted to approximately 40 per cent of the total; in addition, in the period immediately preceding the collapse of the company, there had, according to court evidence, been a significant decrease in Swift's debts to the Deltec Group and a withdrawal of funds by the latter.

foreign credit agreements between parent companies and subsidiaries or between subsidiaries of any one foreign enterprise, the rules of the Common Régime provide that the effective rate of annual interest shall not be more than three points higher than the rate of interest for first-class securities on the financial market of the country of origin of the currency in which the transaction has been registered (art.16).

404. Some countries of the Andean Group have adopted additional provisions. In the case of Peru, the tax rate applicable to foreign loans granted by parent enterprises or by enterprises related to the local firm is four times that levied in the case of loans between independent enterprises; furthermore, in such cases the company liable to taxation is not permitted to deduct from its profits any interest in excess of the interest rate limits established by the legislation.[349]

405. In the other countries there are no provisions dealing directly with foreign loans between parent companies and subsidiaries. It should nevertheless be mentioned that in Brazil remittances of interest must be effected in the manner laid down by the Central Bank Registry, which has the discretionary right to fix the term of the interest charged on foreign loans.[350] In accordance with the Foreign Investments Law, remittances in excess of the rate laid down are regarded as refunds of the repatriable capital of the local company.[351] In the case of Mexico, enterprises benefiting from industrial development régimes must comply with the limits set by the competent authorities in respect of the amount of foreign credit and the interest payable thereon.[352]

B. Control of the international allocation of markets

406. In recent years, transnational enterprises have shown a marked tendency to use their subsidiaries in Latin America as a base for exporting manufactured products to other developing countries both within and outside the region, as well as to the markets of the industrialized countries.[353] In principle, such a development is in line with the objectives of the governments, to expand and diversify their exports or manufactures and semi-manufactures.[354]

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[349] Supreme Decree Nos. 287-68 - M.C./68, art.61 (c), (d) and (e), and art.48; and Leglislative Decree No.18,367/69, art.3

[350] In practice, the Central Bank of Brazil accepts rates of interest slightly higher than those prevailing in the country of origin of the credit.

[351] Law No. 4,131, art.8.

[352] Decree of 23 November 1971, art.22, sect.IV.

[353] See United Nations, Multinational Corporations in World Development, op cit., p. 21; ECLA, "The expansion of international enterprises and their influence on development in Latin America", Economic Survey of Latin America, 1970 (E/CN.12/868).

[354] Statistics show that much of the exporting impetus in the Latin American countries is attributable to the activities of such enterprises. See O. Sunkel, op. cit., p.64 and F. Fanjzylber, "Sistema industrial y exportacíon de manufacturas", ECLA/IPEA, 1970, p.263 et seq.

407. Nevertheless, some doubts arise as to the possible implications of this trend on the control by the governments of their foreign trade policies, and of some strategic aspects of their industrial planning. Firstly, account must be taken of the fact that domestic sales continue to represent the bulk of total sales of foreign subsidiaries, and this applies even in the countries where exports of manufactures have increased most, such as Argentina and Mexico.[355] Moreover, the export activities of the transnational enterprises seem to be greater in those industries that have an oligopolistic structure.[356]

408. Furthermore, a number of the factors that would seem to have led to decisions to export manufactures from Latin American countries give rise to doubts as to the stability of such exports in the longer term, for example, such factors as different rates of inflation, differences in labour costs, the growing obsolescence of certain products in the markets of origin of these products, and exporting to socialist countries to avoid prohibitions on such exports in the transnational corporation's home country.

409. The greatest dangers in the dependence on the participation of the subsidiaries of multinational enterprises in the foreign trade of the countries where they are established arise, oddly enough, from the very same factor on which the superiority of these enterprises as export centres is based, namely, their connexion with a transnational decision-making system that is able to bring together the production and markets of different countries by using a network of information and marketing channels. But the export activities of the subsidiaries do not necessarily imply greater economic efficiency from the standpoint of the individual countries in which the subsidiaries operate. The export strategy of the transnational enterprises makes the subsidiaries instruments of a global plan in which each subsidiary is clearly assigned specified production and distribution activities. The practical result of this is the elimination of any competition between the subsidiaries and the parent in the various countries. In addition, the global plan for exports may involve international cartel activity among various competing transnational groups.

410. All the situations referred to above might result in loss of autonomy or of control by the host countries.[357] as regards sources of inputs, types of link between countries and foreign markets. The direct harmful effects on national export potential

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[355] See, for Argentina, Fundación de Investigaciones Económicas Latinoamericanos (FIEL), Las inversiones extranjeras en la Argentina, 1971, p.264 et seq., A. Ferrer, "El capital extranjero en la economia argentina" in El Trimestre Económico, Vol. 38 (2), No. 150, April-June 1971. For Mexico, see Manuel Aguilera, "Ensayo sobre la IED en Mexico" in Planeación y Desarrollo, July-August 1973, quoted in B. Sepulveda, El caballo de Troya: la empresa transnacional en Mexico, Colegio de México, 1973, p.54.

[356] See R. Vernon, Restrictive business practices, The operations of multinational United States enterprises in developing countries, their role in trade and development, United Nations, 1972.

[357] These effects are more serious in the case of export activities that are based on labour-intensive production, assembly work and component production in vertically integrated international industries, as described by G. Helleiner in "Manufacturas par exportación, empresas multinacionales y desarrollo económico", Comercio Exterior, November 1973, pp. 1134-1142.

occur mainly in cases where there is a division of markets between the subsidiaries of an individual transnational enterprise, or between different competing companies. In Latin America this type of restrictive practice carries the additional risk that it may frustrate the aims pursued in regional integration schemes undertaken by the countries of the region.[358]

411. It is extremely difficult for governments to control arrangements to divide markets among subsidiaries of transnational enterprises as the decisions concerned are taken, communicated and applied through the internal channels of the company, without any formal announcements or express agreements. In the division of markets, unlike in transfer pricing, it is almost impossible to detect or directly control the effects of the restrictive practices, or to penalize their use. Although some arrangements to divide markets are explicitly set out in restrictive clauses on exports in licensing agreements, it is practically impossible to ensure the non-application of such clauses, which are prohibited by law in a number of Latin American laws, when the licensee enterprise is the subsidiary of a transnational enterprise.

412. However, various Latin American governments have made attempts to exercise such control, by different means. Reference has already been made to certain economic policy measures that can directly or indirectly affect the direction of the export activities of foreign subsidiaries.

413. General measures include, in particular, the new régimes applicable to foreign investment. The new laws enacted by Argentina, Mexico and the Andean Group attach special importance to the export activities of enterprises as one of the criteria for cost/benefit analysis of foreign investment.[359]

414. Argentina's law also includes a provision to the effect that contracts for the investment of foreign capital must ensure that the goods or services to be produced shall be exported on the basis of an express undertaking that there will be a net benefit for Argentina, in terms of the foreign exchange balance, as a result of the investment (article 50, paragraph 4). It is also provided that no foreign capital may be brought in that is subject to limitation of export opportunities, or where exports are affected by restrictive agreements of any kind (article 6, paragraph (a)). In Mexico and in the Andean Group, because of the importance attached to exports of manufactures, foreign subsidiaries are exempted in some cases from the general rules on Mexicanization or the rule requiring gradual transformation into a mixed enterprise.[360]

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[358] On the relations between multinational enterprises and the complementarity agreements of the Latin American Free Trade Association (LAFTA), see C. Ianni, "La crisis de la ALALC y las coproraciones internacionales" in Comercio Exterior, December 1972.

[359] See article 5 of the Argentine law, article 13, paragraph III of the Mexican law, and the annex to Decision No. 24.

[360] See Decision No. 1 of Mexico's National Commission on Foreign Investment, which enables enterprises undertaking assembly work for export to establish in Mexico and operate with 100 per cent foreign capital; see also article 35 of Decision No. 24 of the Cartagena Agreement, which exempts from the obligation of gradual transformation any enterprise of whose output 80 per cent is destined for markets in third countries.

415. More specific measures have also been adopted which take account of the particular nature of multinational enterprises, with the apparent aim of placing governments, by various different means, in a position to negotiate directly with such enterprises. Despite the different approaches and methods the countries have employed in dealing with this problem, some important common characteristics can be observed, such as the use of the contract technique, the intervention of State enterprises, the idea of the "foreign exchange balance", and the emphasis on certain sectors, such as the motor vehicle and transport equipment sectors, that are typical of the oligopolistic activity of the multinational enterprises which dominate that sector in Latin America.

416. In Argentina, the régime for the transformation of the motor vehicle industry (Régimen de Reconversión de la Industria automotriz)[361] introduced a programme of rationalization, suspended the establishment of any new enterprise for 10 years, and established strict control over the introduction of new models. One of the main objectives of the system was to promote the export of motor vehicles and spare parts. In the case of passenger cars it was laid down that new models could be introduced only on the basis of a certain ratio between total production and the number of models produced.[362] For the purpose of this calculation, the legislation permitted the Department of Industry to take into account the equivalent number of units, at their f.o.b. value, represented by the total amount of foreign exchange inflow during the same period, in the form of non-compensated exports (not offset by imports) of vehicles, automobile parts, dies, or technological data. In the case of the spare parts industry it was decided to authorize the production of new items if, inter alia, firm commitments were undertaken to export, for a period of five years, an annual total representing at least 50 per cent of the output. Soon after, the Government took stronger measures to encourage the export orientation of the finished product sector of the industry and established compulsory export programmes for the existing enterprises.[363] These programmes calculate future exports on the basis of a rising ratio of exports to total sales, starting from the base year, with a ratio of 100 per cent to be attained by 1978. Furthermore, an increase in sales to the domestic market is made conditional on fulfilment of the export programmes, and if the latter are not fulfilled, domestic sales must be adjusted in inverse ratio to the exports not achieved.

417. An interesting example of negotiation between a government and a transnational enterprise was the agreement concluded in 1972 [364] between the Ministry of Industry and Mining and SAAB Scania of Sweden. The Swedish company undertook to set up a truck manufacturing plant with the attached condition that it would gradually achieve

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[361] Law No. 19,135 of 21 July 1971.

[362] Calculated on a base series for each year, starting from 15,000 units in 1973 and rising to 50,000 units in 1980.

[363] Decree No. 660 of 20 December 1973.

[364] Decree No. 6,564 of 26 July 1972, in which the agreement was published.

specified minimum production capacities and export ratios. The obligation to export was established in terms of amounts of foreign exchange for the six years following the start of production 365/, and was expressly agreed to, as a joint undertaking, by the local subsidiary and its foreign parent company.

418. Another significant example of the exercise of governmental negotiating power occurred in 1973, when the economic co-operation agreement between Argentina and Cuba granted the latter country annual credits of $200 million in order to support the Argentine export plan. The agreement related in particular to the export of motor vehicles made in Argentina by subsidiaries of multinational enterprises. For the American subsidiaries the question immediately arose of a conflict with the United States law requiring enterprises, wherever situated, that were managed by United States nationals to obtain special permission from the Treasury Department if they wished to trade with Cuba. The Argentine Government treated the issue of this possible difficulty as involving a question of sovereignty, and considered the possibility of itself purchasing the output of enterprises having this difficulty in carrying out the programme, and then itself arranging export of the goods to Cuba. The information now available indicates that these difficulties have been overcome, and the enterprises concerned have taken an active part in carrying out the Argentine-Cuban agreement.366/

419. In Brazil, the Latin American country which has recorded the greatest increase in industrial exports by foreign subsidiaries, the Government has used a combination of methods to encourage or press for increased exports by such enterprises and the adjustment of their market allocation programmes to the national plans.367/

420. One of the main tools of the Brazilian export promotion programme is the Commission for the Granting of Tax Advantages to Special Export Programmes (BEFIEX). This Commission was established in 1972 as it was believed that the marketing potential of the multinational enterprises gave them special advantages as far as access to the international market for manufactures was concerned.368/ The use of these advantages is to be encouraged, apparently, by the granting of tax benefits that will ensure lower production costs in Brazil for these enterprises. The granting of fiscal benefits - mainly consisting of duty-free import for machinery - is made conditional on the prior

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365/ Taking into account the fact that the same company had an engine manufacturing plant in Brazil, the agreement permitted the import of engine parts from that country during the first year to a value equal to 5.3 per cent of each vehicle. It was laid down that exports to Brazil would not benefit from any incentives.

366/ See Progreso, April-May 1974, pp. 25-27. The FIAT company was the first to sign an export contract with the Cuban Government. Subsidiaries of Ford, Chrysler and General Motors were concluding their negotiations with Cuba in mid-1974.

367/ One of the main weapons in the Brazilian Government's armoury for negotiation with the multinational enterprises appears to be use of the growth capacity of the domestic market. The Government has recently taken significant measures that show how an anti-inflationary policy can be used - essentially through credit and price control - to discourage internal demand and oblige enterprises to export as a means of maintaining their growth. See Jornal do Brasil, 25 April 1974, p.5.

368/ See Jornal do Brasil, 8 December 1973, p.26. BEFIEX was established by Legislative Decree No. 1,219 of May 1972.

conclusion of export agreements, and they are granted only for that portion of the imports which does not exceed 50 per cent of the total value of the enterprise's exports under the programme. A similar reasoning appears to underlie Legislative Decree No. 1,236, which establishes a system for the installation of foreign plants in Brazil if their output is intended essentially for export.369/ In this case, too, the enterprises must sign an undertaking with BEFIEX to export a given amount for a 10-year period.

421. Another important measure is legislative decree No. 1,240, which establishes fiscal incentives for the export of the mineral ores found in abundance in Brazil.370/ This decree grants mining enterprises, substantial reductions on the taxes payable on dividends distributed to non-resident shareholders. In return, the enterprise must meet, *inter alia*, the following requirements:

(a) a majority of the voting capital must be domestically owned;

(b) the enterprise must export at least half of its production, and

(c) the foreign enterprise participating in the project must buy for its own consumption abroad a proportion of the production not less than the proportion it owns of the capital of the local company operating the business. This last requirement must be specified in the form of firm contracts to purchase output for a period of not less than 10 years.

422. A number of export programmes are also administered by the Industrial Development Council (CDI). The one most extensively applied so far is the programme for the motor vehicle industry. Here the relevant provisions 371/ specify that the import of spare parts and components with the benefit of fiscal incentives is conditional on the export of vehicles, assemblies or components in which the domestic value added must be at least three times the value of the imports.372/ The Brazilian authorities consider that, by using this type of measure, effective pressure can be brought to bear on the head offices of transnational enterprises with subsidiaries in Brazil to modify their over-all plans for reserving markets. In the case of the motor vehicle industry signficant results have been obtained with subsidiaries of United States companies and with the local subsidiary of Volkswagen.373/

369/ Legislative Decree No. 1,236 of 28 August, 1972. This system limits the sale of output on the domestic market to an annual quota which is fixed in the light of the lack or insufficiency of domestic production.

370/ Legislative Decree No. 1,240 of 11 October 1972.

371/ See CDI, Decision No. 20 of 1972. Other important decisions are Decision No. 19, on export programmes in the pharmaceutical industry, and Decision No. 29, on industries that are not of interest for industrial development but whose output is intended essentially for foreign markets.

372/ Moreover, enterprises must undertake to export goods to an average annual value of at least $40 million.

373/ This firm signed an undertaking to export goods to an annual value of $100 million, beginning in 1974, thus ensuring sales of all the parts required for Volkswagen car assembly throughout the world, except in Germany. See *Jornal do Brasil*, 21 February 1974, p.12.

423. The Government has also begun to apply the Japanese system of export "trading companies" or consortiums, and has approved a special régime for this type of organization.374/ Initially the system was looked on as a method of supporting the growth of small or medium-size domestic firms, with exclusion or restriction of the participation of foreign enterprises,375/ but the Government immediately made it clear that this type of undertaking was intended for large companies, requiring a substantial minimum capital and expressly requiring that the applicants should show the existence of a foreign operations machinery or external marketing network,376/ or, in other words, links with a system such as is possessed only by the transnational enterprises. The Government itself, however, has set up a trading company, the Companhia Brasileira de Entrepostos e Comercio (COBEC), with the object of putting the Brazilian exporting firms on a better competitive footing vis-à-vis foreign enterprises.377/ Attention should also be drawn to the recent signing of a number of agreements between Brazilian State enterprises and subsidiaries of American and Japanese transnational enterprises for the setting up of joint ventures under Brazilian control in basic industrial sectors oriented to both the domestic and external markets.378/

424. In Colombia some important measures have been taken in the field of promotion of industrial exports. The system of global import licences 379/ has made possible the introduction of contracts for minimum export volumes with certain enterprises, generally foreign-owned concerns. Furthermore, Decision No. 015/72 of the Board of Foreign Trade established a programme of export quotas under which enterprises interested in receiving more favourable treatment in the financing of exports and the import of machinery must conclude with the Government agreements whereby they undertake to export an increasing proportion of their output each year.

425. Colombia can also show some important examples of association of the State with subsidiaries of transnational enterprises for the purpose of carrying out joint ventures in activities with a high export component. In the extractive industries sector, the Industrial Development Institute (IFI), controlled by the State, has set up joint ventures with the enterprises Chevron and Peabody for the development of nickel and copper deposits, laying down important conditions regarding national control, the training of local personnel, etc.380/ From the standpoint of the present study, however, the most interesting cases are to be found in the motor vehicle industry.

374/ Legislative Decree No. 1,248 of 29 November 1972.

375/ See Business Latin America, 14 December 1972, p.397.

376/ Communication No. 422 of the Foreign Trade Office.

377/ See Jornal do Brasil, Revista Economica, 16 April 1974, p.27.

378/ See chapter IV, para. 245.

379/ Administered by INCOMEX under the powers conferred on it by Decree No. 444 of 1967.

380/ The "Cerro Matoso" and "Carbones el Cerrejon" projects, respectively. For the plan of the latter project, see Ministry of Economic Development, La politica del Ministerio de Desarrollo, Vol. II, February 1973, p. 119-133.

In this sector IFI has entered into association with the local subsidiaries of Renault and FIAT, two of the three domestic assembly firms, in a joint programme for the manufacture, assembly and marketing of vehicles. In the case of the joint venture with Renault the intitial agreement was renegotiated in order to obtain a larger share in the profits and management for the Colombian enterprise. The present agreement also incorporates a programme for the production of parts for export under which a minimum output, as well as purchase and price are guaranteed by the French partner, and a system of trade offsetting is established covering imports of assemblies for local manufacture and exports of products to France. In the case of FIAT the agreement establishing the joint assembly company also includes an undertaking to offset imports of parts against exports, and for this purpose the Italian company undertakes to sell the products made in Colombia in foreign markets at world prices.381/

426. In Mexico, too, the system of export promotion has used the method of making the grant of various benefits conditional on the execution of stable export plans. The main instrument generally used to obtain export undertakings from the enterprises is the "manufacturing programme". Export undertakings usually include trade offsetting obligations aimed at ensuring a positive balance in the foreign exchange flow. Under the sectoral plan a Decree has been issued which establishes the conditions for development of the motor vehicle industry. This Decree employs a system, also adopted in the Argentine legislation, in which the domestic growth of enterprises is tied to the growth of their exports. A system of production quotas is established, whereby the enterprises must offset with net foreign exchange generated by exports the value of the imports under their basic quota, in accordance with a time-table and by progressive increases until the level of 100 per cent is reached in 1979.

427. In Peru there have been a number of recent examples of the establishment of joint enterprises, involving the State holding company INDUPERU and subsidiaries of transnational firms, to engage in production of which a substantial proportion is intended for the extended market of the Andean Group, and for third countries. The most important projects include the establishment of a tractor plant jointly with Massey Ferguson (Tractores Andinos); a diesel engine plant with Volvo and Perkins (Motores Diesel Andinos), and a machine-tool plant with the Romanian foreign trade enterprise UZINEXPORT IMPORT. In all these cases the Peruvian Government has reserved for itself the decision-making power through the structure of the corporate capital which includes two types of shares, as well as veto power on the most important questions. The Government has also been able to obtain special terms in the licensing, supply and marketing contracts concluded with these mixed enterprises. The arrangement with Massey Ferguson provides, for example, for an undertaking by that enterprise to export a volume of products equal to its imports of equipment. In the joint enterprise with Romania the contract covering the licensing and production terms gives the company exclusive production rights in the Andean Group, exclusive Latin American marketing rights for the unfinished goods imported from Romania and freedom to represent other producers and provides for the application of severe penalties if the technology is unsuitable for execution of the project.

428. Lastly, it should be mentioned that various Latin American countries have introduced systems of joint planning of investment within the framework of economic integration schemes, which include appropriate methods of guiding the exporting decisions

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381/ See a detailed description of the negotiations with FIAT and Renault in Ministry of Economic Development, op. cit., pp. 79-118.

of the transnational enterprises in accordance with programmes for the international allocation of markets (at the regional level) that have been established by intergovernmental agreement. The most interesting possibilities are developing in the Andean Group, where there is a system of sectoral industrial development programmes.[382] These programmes, which form part of the plan for trade liberalization, are restricted to such dynamic industrial sectors as the motor vehicle, chemical and electronic industries, and their purpose is to establish an intrasectoral distribution of production among the member countries, with a view to benefiting from economies of scale, harmonizing the industrial policies of the member countries and undertaking joint negotiations with foreign investors on conditions of participation.[383]

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[382] See articles 32 to 40 of the Cartagena Agreement.

[383] See Decision No. 57 of 1972, which established the programme for the metallurgical and engineering sector. Negotiations concerning the programmes for the motor vehicle and petrochemical sectors are now well advanced.